



# ***PR 2011/5 - Income tax: tax consequences of investing in equities using the Macquarie Geared Equities Investment plus (2011 Product Brochure)***

 This cover sheet is provided for information only. It does not form part of *PR 2011/5 - Income tax: tax consequences of investing in equities using the Macquarie Geared Equities Investment plus (2011 Product Brochure)*

 This document has changed over time. This is a consolidated version of the ruling which was published on 9 March 2011



## Product Ruling

### Income tax: tax consequences of investing in equities using the Macquarie Geared Equities Investment plus (2011 Product Brochure)

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives 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. The Commissioner recommends 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

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This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

## What this Ruling is about

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1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.
2. In this Product Ruling the scheme is referred to as Macquarie Geared Equities Investment plus (GEI plus) which is a loan offered by Macquarie Bank Limited (the Bank) to acquire a selection of securities, including securities listed on the Australian Securities Exchange and units in registered managed investment schemes (GEI Securities) under the GEI plus Product Brochure 2011 dated 2 March 2011 (Product Brochure).
3. This Ruling does not deal with the tax consequences of:
  - a GEI plus loan advanced against an existing portfolio of GEI Securities;
  - rolling the GEI Securities into a new GEI plus loan for another term; or
  - the Limited Trading feature,which are available under the terms of the scheme and described in the Product Brochure.
4. Interest deductions under section 8-1 for the amount referred to in subparagraph 20(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.
5. This Ruling also does not address:
  - an Investor's entitlement to franking credits;
  - the tax consequences of a refund of prepaid interest in accordance with clause 4.6 of the Loan and Security Agreement;
  - the tax consequences of any expenditure incurred as a result of extending the 'Final Maturity Date' in accordance with the definition in 25.17 of the Loan and Security Agreement;

the tax consequences of any upfront or trailing commissions, including any arrangement whereby commissions are rebated by a financial adviser to an Investor:

- whether the GEI plus constitutes a financial arrangement for the purposes of Division 230 (Taxation of financial arrangements);
- the tax consequences of an early termination of the GEI plus upon the occurrence of an Event of Default; and
- the tax consequences of any transactions entered into as a result of a corporate action.

### **Class of entities**

6. This part of the Product Ruling specifies which entities:

- are subject to the taxation obligations; and
- can rely on the taxation benefits,

set out in the Ruling section of this Product Ruling.

7. The class of entities who can rely on this Product Ruling consists of those entities:

- who enter into the scheme described in paragraphs 21 to 25 of this Product Ruling and execute relevant Agreements mentioned in paragraph 21 of this Product Ruling:
  - on or after the date this Product Ruling is published, being 9 March 2011, and on or before 30 June 2013;

and, at the time of entering into the scheme,

- they must have a genuine intention of holding their GEI Securities until such time as they derive assessable income (other than capital gains) from the investment that exceeds the deductible expenditure.

These entities are referred to as Investor/s.

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

- do not hold their GEI Securities for the full term, or who otherwise do not have a genuine intention of holding their GEI Securities until such time as they derive assessable income (other than capital gains) from the investment that exceeds their deductible expenditure;
- hold GEI Securities that are non-income producing;

- are accepted to participate into the scheme before the date of this Ruling or after 30 June 2013;
- participate in the scheme through offers made other than through the Product Brochure, or who enter into an undisclosed arrangement with the promoter or a promoter associate, or an independent adviser that is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits) in any way;
- have their GEI plus loan advanced against an existing portfolio of GEI Securities;
- fail to give the required instructions regarding which GEI Securities to acquire such that clause 1.4(e) of the Loan and Security Agreement is activated and the Facility is terminated;
- are not both the Owner and Borrower as defined in clause 25.17 of the Loan and Security Agreement; or
- are subject to Division 230 in respect of this scheme. Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.

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

9. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993 (SISA)*. The Commissioner gives no assurance that the scheme 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 scheme may contravene the provisions of SISA.

## **Qualifications**

10. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 21 to 25 of this Ruling.

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

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

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## **Date of effect**

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13. This Product Ruling applies prospectively from 9 March 2011. It therefore applies only to the specified class of entities that enter into the scheme from 9 March 2011 until 30 June 2013, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application has ended for the scheme entered into during the period of application.

14. 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.

### **Changes in the law**

15. Although this Product Ruling deals with the income tax 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. 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.

### **Proposed amendments to Division 247**

17. On 25 November 2010, the Government presented the Tax Laws Amendment (2010 Measures No. 5) Bill 2010 to give effect to announced changes to the benchmark interest rate in the capital protected borrowing rules referred to in subparagraphs 20(a), (b), and (c) of this Ruling. These changes apply to 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 cease to have effect.

18. As this proposed law has not been enacted, the Commissioner cannot give a legally binding ruling on these changes until the relevant legislation is enacted. Once the changes are enacted, this Product Ruling will be reviewed to reflect the changes in the law.

## **Note to promoters and advisers**

19. 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 Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

## **Ruling**

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20. Subject to paragraphs 3, 4 and 5 of this Ruling, and the assumptions in paragraph 25 of this Ruling:

- (a) in relation to the GEI plus loan, Division 247 will apply to treat the excess (if any) calculated under the method statement in subsection 247-20(3) as being reasonably attributable to the cost of capital protection for the income year;
- (b) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection under Division 247 in an income year is the amount by which the interest charged on the GEI plus loan 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 Rate for Personal Unsecured Loans – Variable Rate (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 (subsection 247-20(4)); 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 (subsection 247-20(5));

- (c) the amount reasonably attributable to the cost of capital protection under Division 247, as worked out under subparagraph 20(b) of this Ruling, is treated as the cost of 'deemed' put options (Put Options) granted by the Bank to the Investor under subsection 247-20(6). This amount is not deductible under section 8-1;
- (d) an amount equal to the expense incurred for interest on the GEI plus loan reduced by the cost of the 'deemed' put options will be deductible under 8-1;
- (e) an amount equal to the expense incurred for interest on the Interest Prepayment Loan will be deductible under section 8-1. Division 247 will not apply to this loan;
- (f) 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;
- (g) 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);
- (h) 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;
- (i) 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;



- (j) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for prepaid interest on borrowings under a GEI plus loan that is allowable under section 8-1 of the ITAA 1997 to an Investor (other than a small business entity that has not chosen to apply section 82KZMD to the expenditure) who is a taxpayer that is not an individual and does not carry on a business;
- (k) if an Investor does not exercise a Put Option by the relevant date, the Put Option will expire (subsection 247-30(2)). The proportion of the total cost of the Put Options that is reasonably attributable to that Put Option will form part of the cost base (under subsection 110-25(2)) and the reduced cost base (under subsection 110-55(2)) of the Put Option;
- (l) CGT Event C2 will happen under section 104-25 if a Put Option is not exercised by the Final Maturity Date and expires. An Investor will make a capital loss that is equal to the reduced cost base of that Put Option;
- (m) if an Investor exercises a Put Option in relation to a GEI Security 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 that GEI Security pursuant to item 2 of the table in subsection 134-1(1). Any capital gain or capital loss the Investor makes from exercising a Put Option will be disregarded under subsection 134-1(4);
- (n) if an Investor repays the GEI plus loan and sells GEI Securities to fund the repayment, CGT event A1 will happen under section 104-10. The Investor will make a capital gain on selling the GEI Securities equal to the capital proceeds less the cost base of the GEI Securities;
- (o) 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 Investor in respect of borrowings under a GEI plus loan or the Interest Prepayment Loan (if applicable) used to fund the purchase of GEI Securities.

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## Scheme

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21. The scheme that is the subject of this Ruling is identified and described in the following documents:

- Application for a Product Ruling received on 12 October 2010 and additional information provided on 17 December 2010; and
- GEI plus Product Brochure dated 2 March 2011, including the Loan and Security Agreement and Interest Prepayment Loan Agreement;
- Draft GEI plus Application Form dated 2 March 2011.

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

22. The documents described in paragraph 21 of this Ruling are those that an Investor may enter into. For the purposes of describing the scheme to which this 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.

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

## Overview

24. Following is a summary of the scheme.

- (a) Under the scheme, Investors borrow funds from the Bank to finance the purchase of GEI Securities. The GEI Securities are shares, units in certain widely held trusts and/or stapled securities listed on the ASX, or units in trusts that are managed investment schemes, as defined in section 9 of the *Corporations Act 2001*, and that are registered under section 601EB of that Act. Where the GEI 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 GEI Securities or a portfolio of GEI Securities up to the amount of funds borrowed from the Bank from an approved list of GEI Securities which is available on the GEI plus website. The minimum loan amount is \$50,000.

- (c) At the Investor's option, 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 basis. Alternatively, Investors may fix their interest rate for one 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 GEI 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 GEI Securities held. The interest rate will also depend upon the term of the GEI plus loan. Generally, the shorter the period of the GEI plus loan and the greater the risk to the Bank given the security offered by the GEI 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 starts on the day interest is payable for an interest period on the GEI plus loan and ends on the last day of that interest period, and generally will not exceed 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 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 Bank. 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, as legal and beneficial owner (or where the Investor is a trustee of a trust, as legal owner) of the GEI Securities, grants a mortgage to the Bank over the acquired GEI 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 GEI Securities held as security.

- (h) The limited recourse loan facility operates to limit the Investor's liability under the loan facility to the GEI 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 the Investor's GEI Securities (or of one or more types of GEI Securities) has fallen below the acquisition cost of those GEI 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 GEI Securities (or the type(s) of GEI 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 type(s) of GEI 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 on the 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 GEI plus loan on the Final Maturity Date; and/or
  - (ii) the Investor intends to activate the limited recourse loan facility; and/or
  - (iii) the Investor intends to refinance the scheme and extend the term of all or part of their GEI plus loan.
- (k) Any ordinary dividends or trust distributions paid in respect of the GEI Securities acquired under the scheme are paid to the Investor, although in some circumstances, the Investor may be required to reinvest the distributions to acquire further GEI Securities of the same type.
- (l) Any further securities acquired or bonus securities 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 securities, and any bonus or further securities, be below the cost of the original parcel of GEI Securities, the original plus any bonus or further securities 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 GEI Securities, carrying on a business of investing in the GEI Securities, or holding GEI 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 the time of any interest prepayment, where the GEI Securities include units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (e) where the GEI Securities acquired by an Investor include units in a trust, it is reasonable to expect that the Investor will derive trust income from those units;
- (f) the dominant purpose of an Investor in entering the scheme is to derive an amount of assessable income from their GEI Securities acquired under the scheme, comprising dividends and/or trust distributions and capital gains, that exceeds the total expenses incurred;
- (g) the scheme will be executed in the manner described in the Scheme section of this Ruling and in accordance with the scheme documentation mentioned in paragraph 21 of this Ruling;
- (h) all dealings by the Investors and the Bank under the scheme will be at arm's length; and
- (i) the Investors will not be subject to Division 230 in respect of the scheme. Division 230 will generally not apply to individuals unless they have made an election for it to apply to them.

## 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 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.

27. Section 247-10 describes when a borrowing under an arrangement satisfies the requirements as a capital protected borrowing. Subsection 247-10(1) states:

An \*arrangement under which a \*borrowing is made, or credits is provided, is a **capital protected borrowing** if the borrower is wholly or partly protected against a fall in the \*market value of thing (the **protected thing**) to the extent that:

- (a) the borrower uses the amount borrowed or credit provided to acquire the protected thing; or
- (b) the borrower uses the protected thing as security for the borrowing or provision of credit.

28. Subsection 247-10(2) states:

That protection is called **capital protection**.

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) as set out in subparagraph 20(b) of this Ruling. This amount is treated as the cost of the Investor's Put Options under subsection 247-20(6).

30. For an Investor in the scheme, a Put Option is a capital asset. As the cost of capital protection is the cost of the Investor's Put Options, this expense is capital in nature. The interest charged on the GEI plus loan will be deductible under section 8-1 only to the extent that it does not constitute the cost of capital protection.

31. Under the arrangement where an Investor chooses to enter into a full recourse Interest Prepayment Loan in addition to a limited recourse GEI plus loan, only the borrowing under the limited recourse GEI plus loan is considered to be subject to capital protection.

32. An Interest Prepayment Loan can only be taken out by an Investor on a full recourse basis. There is no element of capital protection connected with this type of loan.

33. The Bank is entitled to apply the proceeds from the sale of an Investor's GEI Securities to effectively meet all outstanding loan amounts of the Investor on the Final Maturity Date. However, as the Interest Prepayment Loan is issued on a full recourse basis, the Investor will need to use their own funds to cover the shortfall (including any break costs), that is associated with this loan.

## **Section 51AAA**

34. Under the scheme it is contemplated that over the period of an Investor's involvement there will be assessable income derived by way of dividend income and/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**

35. 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**

36. 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 – small business entities for the purposes of Subdivision H**

37. Under section 328-110, 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**

38. 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 loan.

**Sections 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ style arrangements**

39. 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’ style arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

40. 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 scheme, including the financing, share and/or unit purchase, share and/or unit holding and disposal arrangements.



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

- the prepaid interest expenditure under the GEI plus loan is incurred in respect of money borrowed to acquire GEI 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 and/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 scheme are at arm's length.

42. Deductibility of the prepaid interest must therefore be considered under the prepayment rules contained in paragraphs 43 to 48 of this Ruling.

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

43. 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.

44. 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.

45. 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.

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

46. Sections 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 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.

47. 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.

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

**Division 110 – cost base of the Put Options**

49. The cost of capital protection is not deductible to the Investor under section 8-1 (refer to paragraph 20 of this Ruling) and is included in the first element of the cost base (under subsection 110-25(2)) and the reduced cost base (under subsection 110-55(2)) of a Put Option acquired by the Investor. Each Put Option constitutes a CGT asset, and is separate and in addition to the other rights created under the scheme as described in this Ruling.

50. As a single interest rate applies in respect of the GEI plus loan, including where more than one type of GEI Security is held, the investment will be treated as one arrangement for the purposes of Division 247. However, as a separate Put Option is deemed to be provided in respect of each type of GEI Security acquired with the GEI plus loan, the cost of capital protection will need to be reasonably apportioned to each Put Option. The proportion of the cost of capital protection that is reasonably attributable to each Put Option is the cost of each type of GEI Security acquired with the GEI plus loan divided by the cost of all of the GEI Securities acquired with the GEI plus loan, multiplied by the cost of capital protection.

51. If the Investor exercises a Put Option at the end of the GEI plus loan term by relying on the limited recourse provisions of the loan in relation to a type of GEI Security, the Investor will include the payment they are deemed to have made to acquire the Put Option in the second element of the Investor's cost base and reduced cost base of the GEI Security disposed of by the Bank (on behalf of the Investor) under its rights as mortgagee, pursuant to item 2 of the table in subsection 134-1(1). Any capital gain or capital loss the Investor makes from exercising a Put Option is disregarded under subsection 131-1(4).

52. Although the sale proceeds will be insufficient to repay the GEI plus loan, the Bank will have no recourse against the Investor to recover the shortfall. In this circumstance, the Investor will need to reduce the cost base (under subsection 110-45(3)) and the reduced cost base (under subsection 110-55(6)) of the GEI Security by the amount of the shortfall. The combined effect will be to give rise to a capital loss equal to, at the very least, the cost base of the Put Option.

53. If the Investor does not exercise a Put Option by the Maturity Date, the Put Option will be taken to have expired under subsection 247-30(2). This will cause CGT event C2 to happen pursuant to paragraph 104-25(1)(c). The Investor will make a capital loss at that time, equal to the reduced cost base of the Put Option. This would occur where:

- (a) the Investor sold the GEI Securities and repaid the GEI plus loan at the Final Maturity Date, where the capital proceeds were higher than the balance of the GEI plus loan – this would also cause CGT event A1 to happen to the GEI Securities under section 104-10;
- (b) the Investor repaid the GEI plus loan at the Final Maturity Date, whether from other existing funds or by refinancing the GEI Securities, so that the Investor could retain ownership of the GEI Securities.

#### **Part IVA**

54. Provided that the scheme ruled on is entered into and carried out in the manner described in the scheme documentation and in the Scheme section of this Ruling including the Assumptions (see paragraphs 21 to 25 of this Ruling), it is accepted that the scheme is an ordinary commercial transaction and Part IVA of the ITAA 1936 will not apply.

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

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 95/33

*Subject references:*

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

*Legislative references:*

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|                                   | - ITAA 1997 104-25(3)         |
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