


***PR 2013/12 - Income tax: deductibility of interest incurred under a Commonwealth Bank Protected Loan used to invest in units in an ASX listed cash trust***

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## Product Ruling

### Income tax: deductibility of interest incurred under a Commonwealth Bank Protected Loan used to invest in units in an ASX listed cash trust

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Contents	Para
<b>LEGALLY BINDING SECTION:</b>	
What this Ruling is about	1
Date of effect	11
Ruling	16
Scheme	17
<b>NOT LEGALLY BINDING SECTION:</b>	
Appendix 1:	
Explanation	22
Appendix 2:	
Detailed contents list	35

#### **ⓘ 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

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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 provisions identified in the Ruling section 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 the Commonwealth Bank Protected Loan (Protected Loan) used to acquire Securities which include units in an Australian Securities Exchange (ASX) listed cash trust, and offered by the Commonwealth Bank of Australia (the Bank) under the Options and Lending Facility Product Disclosure Statement (PDS) dated 1 July 2010.
3. This Product Ruling does not address:
  - (a) the taxation consequences of:
    - a Protected Loan advanced against an Existing Parcel of Securities;
    - buying or selling Options in accordance with clause 10 of the Terms and Conditions;
    - using the reduced Protection Premium Facility, as described in paragraph 20(o) of this Product Ruling;
    - implementing any of the portfolio management features in accordance with clauses 9 and 10.7 of the Terms and Conditions, that is, the protection reset feature, the trading facility and writing covered Call Options;
    - extending the Maturity Date of the Protected Loan;
    - refinancing the Protected Loan;
    - paying any fees and costs associated with a Protected Loan (other than interest and the Protection Premium), including an Establishment Fee and Brokerage;
    - using the Protected Loan to finance the exercise price of corporate or executive options;

- a Corporate Action that arises in relation to Securities;
  - a Default Event;
  - the early termination of the Protected Loan, either by agreement with the Bank or by the Bank in accordance with the Terms and Conditions;
  - acquiring and disposing of a Parcel of Securities;
  - exercising and not exercising the Protection Right;
  - income derived from a Parcel of Securities;
  - the deductibility of interest incurred under the Interest in Advance Loan; and
  - prepaying the interest charged under the Protected Loan (except where specifically addressed in the context of sections 82KZME and 82KZMF of the *Income Tax Assessment Act 1936* (ITAA 1936) as per paragraphs 16(d) and 31 to 33 of this Product Ruling);
- (b) the taxation consequences associated with the holding of a Parcel of Securities in trust by the Trustee under the terms of the Trust Deed;
- (c) an investor's entitlement to franking credits; and
- (d) whether this scheme constitutes a financial arrangement for the purposes of Division 230 (Taxation of financial arrangements).

### **Class of entities**

4. This part of the Product Ruling specifies which entities can rely on the Ruling section of this Product Ruling and which entities cannot rely on the Ruling section. In this Product Ruling, those entities that can rely on the Ruling section are referred to as the investor.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that are accepted to participate in the scheme specified below on or after 1 July 2012 and on or before 30 June 2015. They must have a purpose of remaining in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income (other than capital gains) from the investment that exceeds the deductible expenditure.

6. The class of entities who can rely on this Product Ruling does **not** include entities who:

- intend to terminate their investment in the scheme prior to its completion;
- do not intend to derive assessable income (other than capital gains) from their investment in the scheme that exceeds their deductible expenditure;
- are accepted to participate in the scheme described below before 1 July 2012 or after 30 June 2015;
- acquire a Protected Loan in respect of an Existing Parcel of Securities, or use the Protected Loan to finance the exercise price of corporate or executive options;
- participate in the scheme through offers made other than through the PDS, 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;
- trade in Securities and are treated for taxation purposes as trading in Securities, carrying on a business of investing in the Securities, or holding the Securities as trading stock or as revenue assets; 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***

7. 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**

8. 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 17 to 21 of this Ruling.

9. 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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11. This Product Ruling applies prospectively from 1 July 2012. It therefore applies only to the specified class of entities that enter into the scheme from 1 July 2012 until 30 June 2015, 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.

12. 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**

13. 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 this Product Ruling and, to that extent, this Product Ruling will have no effect.

14. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

## Note to promoters and advisers

15. 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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16. Subject to paragraph 3 of this Ruling and the assumptions in paragraph 21 of this Ruling:

- (a) Where the cost of the Protection Rights is factored into the interest rate charged on the Protected Loans used to acquire a Parcel of Securities comprised of units in an ASX listed cash trust (amongst one or more other Parcels of Securities consisting of Securities other than units in an ASX listed cash trust):
  - (i) the interest incurred under the Protected Loans, 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;
  - (ii) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the interest incurred under the Protected Loans for the income year exceeds:
    - where interest is charged on the Protected Loans from the Bank at a fixed rate for all or part of the term of the Protected Loans and that fixed rate is applicable to the Protected Loans for all or part of the income year, the amount of the Protected Loans multiplied by the sum of the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans and 100 basis points (the adjusted loan rate) at the time when the interest charge is first incurred during the term of the Protected Loans, or the relevant part of the term (subsections 247-20(4) and (5)); and

- where interest is charged on the Protected Loans from the Bank at a variable rate for all or part of the term of the Protected Loans and a variable rate is applicable to the Protected Loans for all or part of the income year, the amount of the Protected Loans multiplied by the average of the adjusted loan rates applicable during those parts of the income year when the Protected Loans is at a variable rate (subsections 247-20(5) and (5A)); and
- (iii) the amount reasonably attributable to the cost of capital protection as worked out under paragraph 16(a)(ii) of this Product Ruling, is treated as the cost of the Protection Rights under subsection 247-20(6). This amount is not deductible under section 8-1.
- (b) Where the cost of the Protection Rights (the Protection Premiums) is paid in full on the Start Date of the corresponding Protected Loans used to acquire a Parcel of Securities comprised of units in an ASX listed cash trust (amongst one or more other Parcels of Securities consisting of Securities other than units in an ASX listed cash trust):
- (i) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the total of the Protection Premiums and the interest incurred under the Protected Loans for the income year exceeds:
- where interest is charged on the Protected Loans from the Bank at a fixed rate for all or part of the term of the Protected Loans and that fixed rate is applicable to the Protected Loans for all or part of the income year, the amount of the Protected Loans multiplied by the adjusted loan rate at the time when the interest charge is first incurred during the term of the Protected Loans, or the relevant part of the term (subsections 247-20(4) and (5)); and

- where interest is charged on the Protected Loans from the Bank at a variable rate for all or part of the term of the Protected Loans and a variable rate is applicable to the Protected Loans for all or part of the income year, the amount of the Protected Loans multiplied by the average of the adjusted loan rates applicable during those parts of the income year when the Protected Loans is at a variable rate (subsections 247-20(5) and (5A));
  - (ii) the amount reasonably attributable to the cost of capital protection as worked out under paragraph 16(b)(i) of this Product Ruling, reduced by the Protection Premiums, is treated as a further cost of the Protection Rights under subsection 247-20(6). For the purposes of this Product Ruling, this further cost of the Protection Rights is referred to as the additional amount;
  - (iii) the additional amount (if any) and the Protection Premiums are not deductible under section 8-1; and
  - (iv) an amount equal to the interest incurred under the Protected Loans, reduced by the additional amount (if any), will be deductible under section 8-1.
- (c) Section 51AAA of the ITAA 1936 will not apply to deny deductibility of the interest under the Protected Loans allowable as a deduction under section 8-1 of the ITAA 1997.
- (d) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for prepaid interest allowable as a deduction under section 8-1 of the ITAA 1997.
- (e) The anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to deny deductibility of the interest incurred by the investor in respect of the Protected Loans used to acquire a Parcel of Securities comprised of units in an ASX listed cash trust (amongst one or more other Parcels of Securities consisting of Securities other than units in an ASX listed cash trust).

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## Scheme

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

- application for a Product Ruling as constituted by documents and information received on 1 March 2013 and 21 March 2013;
- The Options and Lending Facility Product Disclosure Statement dated 1 July 2010, including the Terms and Conditions; and
- Trust Deed received on 21 March 2013.

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

18. 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. Unless otherwise defined, capitalised terms in this Product Ruling take their meaning as per the PDS and Trust Deed.

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

### Overview

20. Following is a summary of the scheme:

- (a) The Protected Loan is a combination of a limited recourse loan and a Protection Right. The funds drawn down under the Protected Loan are used by the investor to finance up to 100% of the purchase price of a portfolio of shares or units listed on the ASX (Securities) on the Start Date, plus any Establishment Fee charged by the Bank to establish the Protected Loan. Where the Protected Loan finances less than 100% of the purchase price of the Securities, the investor is required to contribute the Additional Funds towards the purchase price.

- (b) To apply for a Commonwealth Bank Options and Lending Facility (Facility) the investor must submit a duly completed and signed Application to the Bank. Upon submission of an Application, the investor is immediately bound by the Terms and Conditions, the Trust Deed and each other Transaction Document which together form a single agreement between the investor, the Bank and the Trustee. Where the investor wishes to enter into a Protected Loan, they can request an Indicative Term Sheet from the Bank setting out, amongst other things, the indicative characteristics and financial terms of the Protected Loan. The terms of the Protected Loan will be taken to be agreed between the investor and the Bank when the investor has duly signed and returned the Indicative Term Sheet.
- (c) The investor selects from a range of Securities that the Bank has approved for the purposes of the Protected Loan (Approved Securities). Relevantly, units in an ASX listed cash trust are included as Approved Securities to be acquired with the proceeds of the Protected Loan. Each holding of a particular class of Securities under the Protected Loan (that is, securities issued by the same Issuing Entity and with identical characteristics) is referred to as a Parcel of Securities. A separate Protected Loan will be made available to the investor under the Facility in respect of each Parcel of Securities.
- (d) Each Parcel of Securities is held on Separate Trust by the Trustee on behalf of the investor and on the terms of the Trust Deed to better secure the performance of the investor's obligations (Secured Obligations) under the Protected Loan. To that end, the Trustee grants a Mortgage to the Bank over the Parcel of Securities to secure the investor's obligations under the Protected Loan.
- (e) The minimum Loan Limit that the Bank is prepared to lend to the investor under the Facility is \$25,000, with a minimum of \$5,000 per Parcel of Securities.
- (f) Investors can choose any Term for the Protected Loan, subject to agreement by the Bank, up to a maximum of five years.
- (g) Any Dividends (other than special Dividends reinvested on the investor's behalf) or trust distributions paid in respect of the Parcel of Securities purchased under the Protected Loan are paid to the investor by the Trustee.

(h) A different interest rate will generally apply for each Parcel of Securities, determined by the Bank taking into account a number of factors. Where the investor selects more than one Parcel of Securities, the interest rate across each of the parcels will be the single weighted average interest rate that takes into account all of the Parcels of Securities selected. The inclusion of units in an ASX listed cash trust as one of the Parcels of Securities will lower the weighted average interest rate on the Protected Loans.

(i) Interest payments on the Protected Loan are payable by the investor at either:

- a fixed interest rate, annually in advance;
- a fixed interest rate, monthly in arrears; or
- a variable interest rate, monthly in arrears.

Subject to certain conditions, including the Bank's agreement, an investor may elect to change their interest payment method from a variable interest rate (monthly in arrears) to a fixed interest rate (annually in advance or monthly in arrears), or vice versa. If an investor elects to change their interest payment method from a fixed interest rate to a variable interest rate, this election can only be made at the end of the period that is the subject of the fixed interest rate.

(j) Investors who are not self managed superannuation funds and choose to pay interest on their Protected Loan annually in advance at a fixed interest rate can separately apply for an Interest in Advance Loan which allows them to borrow funds in order to pay that year's Prepaid Interest due and payable under the corresponding Protected Loan. Interest on the Interest in Advance Loan accrues at a fixed interest rate and is paid (together with the principal) over twelve monthly instalments in arrears.

- (k) In consideration for the payment of the Protection Premium in respect of a Protected Loan, the Bank grants to the investor the Protection Right giving the investor the right to require the Bank to purchase their Parcel of Securities on the Maturity Date for an amount equal to the applicable Total Protected Price where the Market Value of the relevant Security within the Parcel is less than its Protected Price. The sale proceeds from such purchase, less the Brokerage, costs and expenses in connection with selling that Parcel of Securities, will be applied towards repayment of the corresponding Protected Loan. The funds borrowed by the investor under the Protected Loan will not exceed the Total Protected Price. The amount of any Additional Funds contributed by the investor towards the purchase price of the Securities is therefore not protected in any way.
- (l) The cost of the Protection Right, being the Protection Premium, may be paid by the investor as a lump sum on the Start Date or it may be reflected in the interest rate payable under the Protected Loan.
- (m) Where the Protected Loan is repaid in full or the Maturity Date occurs and the investor's Purchase Right is not exercised, the Protection Right for that Protected Loan will end.
- (n) The Protected Loan is a limited recourse loan. As such, where the investor fails to repay the Principal Outstanding under a Protected Loan the Bank is only entitled to recover what is owing by selling the relevant Parcel of Securities transferred to it under the Protection Right or exercising its rights under the Trustee Mortgage against the Parcel of Securities held as security.
- (o) The Protected Loan may also contain a reduced Protection Premium facility. This facility allows an investor to obtain a reduced Protection Premium by agreeing to limit their entitlement to the capital growth of their Parcel of Securities where the Final Security Price on the Maturity Date exceeds the Capped Price selected by the investor.
- (p) At least five Business Days prior to the Maturity Date, the investor will need to inform the Bank by irrevocable notice in writing (Maturity Date Notice) that they want to settle the Protected Loan via one of the available methods in respect of the corresponding Parcel of Securities, including the following:

- (i) procure the sale of, or ask the Bank to exercise its rights under the Trustee Mortgage to sell, the entire Parcel of Securities to repay the Protected Loan and receive any surplus;
  - (ii) procure the sale of, or ask the Bank to exercise its rights under the Trustee Mortgage to sell, a portion of the Parcel of Securities to repay the Protected Loan and take delivery of the remaining Securities in the parcel;
  - (iii) sell the entire Parcel of Securities at the Protected Price subject to and in accordance with their Protection Right where the prevailing Market Value of the Security is below its Protected Price, as per paragraph 20(k) of this Product Ruling; or
  - (iv) use their own funds to repay the Protected Loan, take delivery of the Parcel of Securities and, where applicable, receive payment from the Bank of the Cash Settlement Amount (if any).
- (q) Where the Bank does not receive a Maturity Date Notice from the investor earlier than five Business Days prior to the Maturity Date, the Parcel of Securities will be sold at either the prevailing market price of the relevant Security, as determined by the Bank (where that price is equal to or higher than the Security's Protected Price), or at the Protected Price subject to and in accordance with the investor's Protection Right (where the prevailing market price of the relevant Security, as determined by the Bank, is below the Protected Price). The proceeds from such sale will be applied towards repayment of the corresponding Protected Loan and all other amounts owing under the Protected Loan.

### **Assumptions**

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

- (a) all of the investors are Australian residents for taxation purposes;
- (b) at all times during the scheme, where the Securities include shares, those shares satisfy the requirements of subparagraph 82KZME(5)(b)(ii) of the ITAA 1936;
- (c) at all times during the scheme, where the Securities include units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;

- (d) at all times during the scheme, where the Securities include a stapled security, the stapled security comprises shares and/or units that satisfy the requirements of subparagraph 82KZME(5)(b)(ii) and subparagraph 82KZME(5)(b)(iii) of the ITAA 1936, as applicable;
- (e) the investors will hold their interests in the Securities on capital account, are not traders in investments and are not treated for taxation purposes as trading in the Securities, carrying on a business of investing in the Securities, or holding the Securities as trading stock or a revenue asset;
- (f) the dominant purpose of an investor in entering into the scheme is to derive assessable income from their Parcels of Securities acquired under the Protected Loans, comprising Dividends and/or trust distributions and capital gains, which exceeds the total expenses incurred. To that end, the investors will also acquire one or more Parcels of Securities consisting of Securities other than units in a cash trust;
- (g) the scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation referred to in paragraph 17 of this Ruling; and
- (h) all dealings by the investors, the Bank and the Trustee under the scheme will be at arm's length.

## **Appendix 1 – Explanation**

**①** *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**

22. 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 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.

23. Division 247 limits the allowable deductions for expenditure incurred under a 'capital protected borrowing'. Broadly, a capital protected borrowing arises where an amount is borrowed under an arrangement where the borrower is protected against the fall in value of some specified securities, and where that borrowing is made for the purpose of investing in those securities.

24. Division 247 applies to the Protected Loan where the investor uses the Protected Loan to acquire a beneficial interest in a Parcel of Securities (including a Parcel of Securities comprised of units in an ASX listed cash trust) and the investor is protected against the fall in the market value of the Parcel of Securities.

25. Where an investor has acquired multiple Parcels of Securities and the Bank has applied a single interest rate across all the Parcels of Securities held by the investor, the investment will constitute one arrangement for the purposes of Division 247.

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

27. Where the cost of the Protection Rights is factored into the interest rate charged on Protected Loans used to acquire a Parcel of Securities comprised of units in an ASX listed cash trust (amongst one or more other Parcels of Securities consisting of Securities other than units in an ASX listed cash trust), and there is no separate charge payable by an investor for the Protection Rights:

- (a) the cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in paragraph 16(a)(ii) of this Product Ruling;

- (b) under step 1 of the method statement, the total amount incurred by the investor under or in respect of the Protected Loans for the income year is the interest incurred on the Protected Loans for the income year;
- (c) where the total amount incurred by the investor worked out under 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 on the Protected Loans will be fully deductible under section 8-1;
- (d) where the total amount incurred by the investor worked out under step 1 of the method statement is greater than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, the balance is reasonably attributable to the cost of capital protection and is treated as if it were incurred for the Protection Rights (subsection 247-20(6)); and
- (e) the investor's Protection Rights are a capital asset. Therefore, the amount reasonably attributable to the cost of capital protection is capital in nature and not deductible under section 8-1.

28. Where the investor elects to pay the Protection Premiums for the Protection Rights as a lump sum on the Start Date of the corresponding Protection Loans used to acquire a Parcel of Securities comprised of units in an ASX listed cash trust (amongst one or more other Parcels of Securities consisting of Securities other than units in an ASX listed cash trust):

- (a) the cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in paragraph 16(b)(i) of this Product Ruling;
- (b) under step 1 of the method statement, the total amount incurred by the investor under or in respect of the Protected Loans for the income year includes the interest incurred on the Protected Loans and any amounts that are in substance for capital protection (such as the Protection Premiums) for the income year;
- (c) where the total amount incurred by the investor worked out under 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 on the Protected Loans will be fully deductible under section 8-1;

- (d) where the total amount incurred by the investor worked out under step 1 of the method statement is greater than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, the balance is reasonably attributable to the cost of capital protection. In calculating the additional amount (as per paragraph 16(b)(ii) of this Product Ruling), the amount reasonably attributable to the cost of capital protection will be reduced by the actual payment for the Protection Rights (the Protection Premiums) in accordance with subsection 247-20(6). The additional amount, to the extent that it is greater than zero, constitutes a further cost of capital protection in addition to the Protection Premiums; and
- (e) the investor's Protection Rights are a capital asset. Therefore, the Protection Premiums and the additional amount (if any) is capital in nature and not deductible under section 8-1.

### **Section 51AAA**

29. By acquiring Parcels of Securities, it is contemplated that an investor will derive assessable income by way of the receipt of dividend income and/or trust income and capital gains. As the interest incurred on the Protected Loans 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 relation to the Protected Loans.

### **Subdivision H of Division 3 of Part III**

30. 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. 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.

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

31. 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.

32. For the purposes of section 82KZME of the ITAA 1936, 'agreements' are broadly defined to include an entire scheme 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 Protected Loan, including the financing, share and/or unit purchase, share and/or unit holding and disposal arrangements.

33. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, will apply to exclude interest payable under the Protected Loan from the operation of section 82KZMF of the ITAA 1936 where:

- (a) the prepaid interest under the Protected Loan is incurred in respect of money borrowed to acquire Securities that are as described in subparagraphs 82KZME(5)(b)(ii) and (iii) of the ITAA 1936;
- (b) the investor can reasonably be expected to obtain dividends 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 Protected Loan are conducted at arm's length.

## **Part IVA – anti-avoidance**

34. Provided that the scheme ruled on is entered into and carried out as described in this Ruling, it is accepted that the scheme is an ordinary commercial transaction and Part IVA of the ITAA 1936 will not apply to deny deductibility of the interest incurred under Protected Loans.

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

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

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Class of entities	4
<i>Superannuation Industry (Supervision) Act 1993</i>	7
Qualifications	8
<b>Date of effect</b>	<b>11</b>
Changes in the law	13
Note to promoters and advisers	15
<b>Ruling</b>	<b>16</b>
<b>Scheme</b>	<b>17</b>
Overview	20
Assumptions	21
<b>Appendix 1 – Explanation</b>	<b>22</b>
Section 8-1 and Division 247 – capital protected borrowings and deductibility of interest	22
Section 51AAA	29
Subdivision H of Division 3 of Part III	30
Sections 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ style arrangements	31
Part IVA – anti-avoidance	34
<b>Appendix 2 – Detailed contents list</b>	<b>35</b>

## References

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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
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