PR 2014/10 - Income tax: tax consequences for a customer holding a Home Buy Savings Account and a home loan with the Commonwealth Bank of Australia

Product Ruling

Income tax: tax consequences for a customer holding a Home Buy Savings Account and a home loan with the Commonwealth Bank of Australia

Contents Para

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

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 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 an investment in a Home Buy Savings Account (HBSA) offered by the Commonwealth Bank of Australia (CBA) and the subsequent procurement of a CBA home loan by the same CBA customer.

3. This Product Ruling does not address:

- the tax consequences associated with the home loan
- the treatment of any costs, fees and expenses payable by the customer under the scheme
- the customer's tax obligations and benefits in relation to the acquisition, holding and sale of a property purchased with the proceeds of the home loan
- the transfer or assignment of a HBSA, and
- whether the 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 customer.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that enter into the scheme described in paragraphs 16 to 26 of this Product Ruling on or after the date this Ruling is made and on or before 30 June 2017.

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

- are non-residents for Australian taxation purposes

- enter into the scheme described in paragraphs 16 to 26 of this Product Ruling before the date of this Ruling or after 30 June 2017, 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 its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 26 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.

Date of effect

10. This Product Ruling applies prospectively from 4 June 2014, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 4 June 2014 until 30 June 2017, 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.

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.

Changes in the law

12. 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.

13. 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

14. 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

15. Subject to paragraph 3 of this Product Ruling and the assumptions in paragraph 26 of this product Ruling:

(a) The notional bonus interest to accrue on the customer's HBSA will not be assessable income of the customer under section 6-5.

(b) Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to include any or all of the notional bonus interest to accrue on the customer's HBSA in the customer's assessable income.

Scheme

16. 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 12 February 2014 and 27 March 2014, and
- Consumer Mortgage Lending Products - Terms and conditions, dated 27 September 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.

17. 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 the customer, or any associate of the customer, will be a party to, which are a part of the scheme.

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

Overview

19. The HBSA is a deposit account offered by the CBA to residents. Subject to paragraph 22 of this Product Ruling, interest on the HBSA is calculated daily at a rate of 1.00% per annum and paid to the holder(s) of the account (the customer) monthly.

20. Where the customer holding a HBSA later procures any of the relevant eligible home loans, including investment home loans, with the CBA, their HBSA will convert into an offset account allowing the customer to offset the funds in their HBSA against the home loan debt, reducing the interest payable on their home loan.

21. The home loan:

- will be comprised of the Usual Terms and Conditions for Consumer Mortgage Lending and a Schedule setting out the particulars of the loan
- must be held with the CBA for at least three years
- will not incur an application fee or monthly service fee, and
- enables access to the CBA's Wealth Package.

22. The negotiated interest rate applicable to the customer's home loan will be applied to the HBSA, thereby recalculating the prevailing HBSA interest rate of 1.00% per annum to the applicable home loan interest rate. The prevailing HBSA interest rate of 1.00% per annum will not be recalculated as described unless the customer procures a home loan with the CBA.

23. The difference between the home loan interest rate and the initial HBSA interest rate of 1.00% per annum is the 'notional bonus interest'. The notional bonus interest is not paid or credited to the customer, but is used to offset the interest charged on the home loan until the accrued notional bonus interest has been exhausted.

24. The maximum deposit balance on the HBSA which may accrue notional bonus interest will be capped at 25% of the balance of the home loan amount.

25. The customer is restricted from withdrawing more than 10% of the balance of the HBSA within a twelve month period.

Assumptions

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

    (a) the customer is an Australian resident for taxation purposes

    (b) the HBSA will be conducted in the same name(s) as the relevant home loan account

    (c) all dealings between the customer and the CBA will be at arm's length, and

    (d) the scheme will be executed in the manner described in the Scheme section of this Ruling.

Commissioner of Taxation
4 June 2014

Appendix 1 – Explanation

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.

Notional bonus interest not assessable as ordinary income under section 6-5

27. Section 6-5 includes income according to ordinary concepts (ordinary income) in assessable income. Whether or not a particular amount is income according to ordinary concepts depends on the nature and character of the receipt in the hands of the taxpayer.

28. The HBSA constitutes a deposit account on which interest is payable. Typically, the receipt of interest is ordinary income. Accordingly, any interest credited to the customer's HBSA monthly by the CBA at a rate of 1.00% per annum is ordinary income, assessable under section 6-5 in the income year in which it is credited to the customer.

29. In order for the notional bonus interest accruing on the customer's HBSA to be assessable ordinary income, it must be derived by the customer. Ordinary income may be said to be derived pursuant to subsection 6-5(4) which provides that an amount of ordinary income will be taken to be received as soon as it has been applied or dealt with in any way on behalf of or as directed by the taxpayer.

30. The scheme described at paragraphs 16 to 26 of this Product Ruling is similar to the acceptable 'loan account offset arrangements' set out in Taxation Ruling TR 93/6[1] under which a lender allows a person to use savings they hold in a deposit account with the lender to offset against interest payable on that person's loan account. These arrangements are effective for tax purposes on the basis that they're structured so that no interest is derived by the person and therefore no liability to income tax arises in respect of the benefit arising from the loan account.

31. Acceptable loan account offset arrangements, according to TR 93/6, which operate on a dual account basis must operate as per paragraphs 6 and 7 of that Ruling as follows:

> 6. The customer operates two accounts - a loan account and a deposit account. To be acceptable, it is essential that there be no entitlement, either in law or in equity, to receive interest payments or payments in the nature of interest on the amounts credited to the deposit account. The only benefit arising in the deposit account should be the right of the customer to ensure that the interest payable on the loan account is reduced in the way described in paragraph 7.

[1] Income tax and fringe benefits tax: loan account offset arrangements.

> 7. The reduction in the loan account interest referred to in paragraph 6 should be achieved by offsetting the balances of the two accounts. That is, the interest payable on the loan account should be calculated by dividing the outstanding loan principal into two components. A reduced rate of interest (often the lending rate less the ordinary deposit account rate) is charged on an amount equal to the balance of the deposit account. The reduced interest rate can never be a negative, ie. the deposit rate used cannot exceed the loan rate used. In those cases where the deposit rate would exceed the loan rate the deposit rate actually used in the calculation must be limited to the loan rate (see Example 3, paragraphs 31 and 32). The usual lending rate of interest on loans of this type is charged on the remainder of the loan principal.

32. Paragraphs 10 to 13 of TR 93/6 acknowledge that the interest payable on the loan account under an acceptable dual loan account offset arrangement may be calculated differently to that described in paragraph 7. Paragraph 11 of TR 93/6 notes that a calculation based on a set-off of a notional amount of interest accruing on each of the accounts is acceptable, provided that the balance used to calculate the notional interest on the deposit account does not exceed the balance of the loan account.

33. As the notional bonus interest only accrues under the HBSA once the customer procures a home loan with the CBA, and can only be used to offset the customer's interest expense on the home loan, it is not an amount paid or credited to the customer, nor an amount to which the customer has an entitlement (either in law or in equity) and is applied or dealt with on behalf of the customer or as the customer directs. Further, and for the specific purposes of paragraph 11 of TR 93/6, the maximum deposit balance in the HBSA on which notional bonus interest accrues, as per paragraph 24 of this Product Ruling, will be capped to a maximum of 25% of the balance of the home loan and therefore cannot exceed the balance of the home loan account.

34. As no amount of the notional bonus interest to accrue under the HBSA will be received by, or credited to, the customer (either directly or as deemed by subsection 6-5(4)), the reduction in the amount of interest that will otherwise be payable by the customer on the home loan (that is, the amount of notional bonus interest to accrue under the HBSA) will not be subject to tax.

Application of Part IVA

35. Part IVA of the ITAA 1936 is a general anti-avoidance rule which gives the Commissioner the power to cancel all or part of a tax benefit that has been obtained, or would, but for section 177F of the ITAA 1936, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies.

36. In broad terms, Part IVA of the ITAA 1936 will apply where the following requirements are satisfied:

- there is a 'scheme' as defined in section 177A of the ITAA 1936

- there is a 'tax benefit' that, in relation to omitted assessable income, is defined in paragraph (a) of subsection 177C(1) of the ITAA 1936 as an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out
- having regard to the eight objective matters identified in subsection (2) of section 177D of the ITAA 1936, it would be concluded by a reasonable person that there was the necessary dominant purpose of enabling the taxpayer to obtain the tax benefit in connection with the scheme, and
- the Commissioner makes a determination that the whole or part of the amount of the tax benefit that is referable to the omitted assessable income shall be included: paragraph 177F(1)(a) of the ITAA 1936.

Identification of the scheme

37. The term 'scheme' is defined very broadly in section 177A of the ITAA 1936 to mean:

> (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
>
> (b) any scheme, plan, proposal, action, course of action or course of conduct.

38. The precise description of a scheme for the purposes of Part IVA of the ITAA 1936 will depend on the facts of the particular case. The circumstances described in paragraphs 16 to 26 of this Product Ruling constitute a scheme for the purposes of the definition set out in section 177A of the ITAA 1936.

The tax benefit test

39. A tax benefit can arise to the customer in relation to a year of income where their assessable income of a year of income, as a result of not having included any of the notional bonus interest to accrue on their HBSA, is less than that which the customer might reasonably be expected to have derived but for entering into the scheme described in paragraphs 16 to 26 of this Product Ruling.

Dominant purpose

40. Whilst the customer may derive a tax benefit in connection with the scheme described in paragraphs 16 to 26 of this Product Ruling, having regard to the matters listed in paragraphs (a) to (h) of subsection 177D(2) of the ITAA 1936, it is not considered that obtaining the tax benefit is the dominant purpose of the customer in entering into the scheme and Part IVA will not apply to include any or all of the notional bonus interest to accrue on the customer's HBSA in their assessable income.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 93/6

Subject references:

- financial products
- interest income
- interest offset
- product rulings
- public rulings
- savings offset
- tax administration

Legislative references:

- ITAA 1936
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C(1)(a)
- ITAA 1936 177D(2)
- ITAA 1936 177D(2)(a)
- ITAA 1936 177D(2)(b)
- ITAA 1936 177D(2)(c)
- ITAA 1936 177D(2)(d)
- ITAA 1936 177D(2)(e)
- ITAA 1936 177D(2)(f)
- ITAA 1936 177D(2)(g)
- ITAA 1936 177D(2)(h)
- ITAA 1936 177F
- ITAA 1936 177F(1)(a)
- ITAA 1997 6-5
- ITAA 1997 6-5(4)
- ITAA 1997 Div 230
- SISA 1993
- TAA 1953

ATO references

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