


# ***PR 2014/5 - Income tax: Macquarie NRAS Trust***

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## Product Ruling

### Income tax: Macquarie NRAS Trust

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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

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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 an investment in the Macquarie NRAS Trust (the Trust) offered under a Product Disclosure Statement issued by Macquarie Financial Products Management Limited (MFPML) and using a limited recourse loan (the Loan) made by Macquarie Specialist Investments Lending Limited or some other Macquarie Group entity (the Loan Provider).
3. This Product Ruling does not address:
  - (a) the taxation consequences of any fees that may be payable by the Investor under clause 10.1 and/or 10.2 of the Loan and Security Agreement (Loan Agreement);
  - (b) the taxation consequences in the event that the Loan Provider refunds a portion of the Investor's prepaid interest amount paid on the Loan;
  - (c) the taxation consequences in the event that the Investor does not receive any distribution of income from the Trust;
  - (d) the capital gains tax consequences to arise upon the acquisition, sale or transfer of the Investor's Units in the Trust;
  - (e) the taxation consequences of an early termination of the Loan and/or an early redemption of the Units;
  - (f) the taxation consequences of an Event of Default; and
  - (g) 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 Australian residents for taxation purposes and:

- enter into the scheme described in paragraphs 16 to 20 of this Product Ruling on or after the date this Product Ruling is made, being 2 April 2014, and on or before 30 June 2017; and
- have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires).

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

- enter into the scheme described in paragraphs 16 to 20 of this Product Ruling before this Ruling is published or after 30 June 2017;
- intend to terminate their investment in the scheme prior to its completion;
- participate in the scheme through documents other than the agreements referred to in paragraph 16 of this Product Ruling, 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 the Units and are treated for taxation purposes as trading in the Units, carrying on a business of investing in the Units, or holding the Units as trading stock or as a revenue asset; 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 20 of this Product 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

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10. This Product Ruling applies prospectively from 2 April 2014, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 2 April 2014 to 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.

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## Ruling

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15. Subject to paragraph 3 and the assumptions in paragraph 20 of this Product Ruling:

- (a) A Unit in the Trust is not a 'security' as defined in subsection 159GP(1) of the ITAA 1936.
- (b) Investors are deemed under subsection 272-5(3) of Schedule 2F to the ITAA 1936 to have fixed entitlements to all of the income and capital of the Trust.
- (c) The Investor will be assessable under paragraph 97(1)(a) of the ITAA 1936 on so much of that share of the net income of the Trust's estate to which the Investor is presently entitled.
- (d) The Investor will be entitled to a tax offset under subsections 380-15(1) and 380-25(3). The amount of tax offset to which the Investor will be entitled is based on so much of that share of the net income of the Trust's estate to which the Investor is presently entitled and is included in their assessable income in accordance with paragraph 97(1)(a) of the ITAA 1936.
- (e) Interest incurred on the Loan will be deductible under section 8-1. The amount of this deduction is limited to the lesser of:
  - i. the sum of the amount assessable under paragraph 15(c) and the amount the Investor is entitled to under paragraph 15(d) of this Product Ruling; and
  - ii. the amount equal to the interest incurred under the Loan, reduced by the cost of the deemed put option under Division 247 (as per paragraph 15(l) of this Product Ruling).
- (f) The deductible interest will be allowed as a deduction under section 8-1 in the same year as the interest is incurred.
- (g) Section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction for the interest allowable under section 8-1 of the ITAA 1997.
- (h) Section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest allowable under section 8-1 of the ITAA 1997.
- (i) In relation to the 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.

- (j) For the purpose of step 1 under the method statement in subsection 247-20(3), the total amount incurred by the Investor under or in respect of the Loan for the income year will be reduced by an amount equal to the Participation Fee referred to in subparagraph 19(c) of this Product Ruling, as that amount is not in substance for capital protection or interest.
- (k) 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 incurred for interest on the Loan, less an amount equivalent to the Participation Fee referred to in subparagraph 19(c) of this Product Ruling, that exceeds the amount of the Loan multiplied by the *adjusted loan rate*. The adjusted loan rate is the sum of the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans and 100 basis points at the time when the interest is incurred for the term of the Loan (subsections 247-20(4) and (5)).
- (l) The amount reasonably attributable to the cost of capital protection under Division 247, as worked out under subparagraph 15 of this Product Ruling, is treated as the cost of a deemed put option (Put Option) granted by the Loan Provider to the Investor under subsection 247-20(6). This amount is not deductible under section 8-1.
- (m) The cost base and the reduced cost base of the Put Option will include the amount reasonably attributable to the cost of capital protection as calculated under Division 247 (subsections 110-25(2) and 110-55(2)).
- (n) If the Investor does not exercise the Put Option by the Maturity Date, the Put Option will expire (subsection 247-30(2)) and CGT event C2 will happen under section 104-25. The Investor will make a capital loss that is equal to the reduced cost base of the Put Option under subsection 104-25(3).
- (o) The anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to cancel the amount of interest claimed as a deduction by the Investor, as per paragraph 15(e) of this Ruling, in respect of their borrowings under the Loan.

## 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 22 October 2013, 14 February 2014, 6 March 2014 and 10 March 2014;
- **Macquarie NRAS Trust Constitution** (Constitution), dated 27 June 2012;
- draft **Loan and Security Agreement** received on 22 October 2013;
- draft Macquarie NRAS Trust Product Disclosure Statement (PDS) received on 14 February 2014;
- draft pro-forma Macquarie NRAS Trust Term Sheet (Term Sheet) received on 14 February 2014;
- draft Macquarie NRAS Trust Information Booklet received on 14 February 2014; and
- draft Consortium Agreements received on 10 March 2014.

**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. The documents highlighted in paragraph 16 of this Product Ruling are those that an Investor will enter into or be a party to. 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 will be a party to, which are a part of the scheme. Unless otherwise defined, capitalised terms in this Ruling take their meaning as per the documents listed in paragraph 16 in this Ruling.

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

## Overview

19. Following is a summary of the scheme:

- (a) The Trust is an Australian unit trust registered as a managed investment scheme. It is an open ended trust with a termination date no later than 80 years from its commencement. MFPML is the responsible entity of the Trust.



- (b) The Trust, together with the Loan Provider, will enter or has entered into contractual arrangements (Consortium Agreements) with various approved participants as defined in the *National Rental Affordability Scheme Regulations 2008* (NRAS Regulations) (the Approved Participants). The Consortium Agreements provide for the Trust to receive rent (NRAS Rent) in respect of Participating Dwellings. This is achieved by either the Approved Participant assigning the Rental Debts to the Trust or the Trust entering into a Head Lease and Sub Lease arrangement in respect of the Participating Dwellings owned by the Approved Participant or an associate.
- (c) Provided the Approved Participants comply with the requirements of the *National Rental Affordability Scheme Act 2008* (NRAS Act) and the NRAS Regulations in respect of each Participating Dwelling, the Trust will be entitled to receive tax offsets arising under the NRAS Act and the ITAA 1997 (the NRAS Offsets) that would otherwise have been provided to the Approved Participants had they derived the NRAS Rent. In exchange for the NRAS Offsets, the Approved Participants will receive an Annual Consortium Fee from the Trust and a Participation Fee from the Loan Provider.
- (d) The Trust will not be entitled to receive any NRAS incentive arising under the NRAS Act and provided to the Approved Participants by a Department of a State or Territory Government.
- (e) Information regarding each annual Offer to subscribe for Units will be set out in the relevant Term Sheet. Each Term Sheet forms part of the PDS.
- (f) Investors permitted to invest in the Trust include individuals over the age of 18 and companies that receive the Offer in Australia, but exclude trustees of self-managed superannuation funds.
- (g) At the beginning of June (on both the Issue Date and the Loan Drawdown Date), an Investor will subscribe for Units in the Trust using the Loan to finance 100% of their subscription. There will generally be a single class of Units on issue, reflecting a single pool of assets and liabilities. The issue price is \$1 per Unit.
- (h) The Trust will place all subscription amounts for Units issued on interest bearing deposit (Deposit) for the term of the investment with the Depositholder. Most of the interest earned on the Deposit will be applied to meet the obligations of the Trust under the terms of a Consortium Agreement. The Deposit is repayable to the Trust on the Maturity Date.

- (i) The Deposit and the contractual rights and obligations under each Consortium Agreement comprise the assets and liabilities of the Trust.
- (j) Investors on the register of the Trust immediately before the end of the income year will be presently entitled to the net income of the Trust in accordance with the Constitution. The Trust will distribute its net income (that is, the portion of the interest earned on the Deposit which is not used by the Trust to meet its obligations under a Consortium Agreement) to the Investors on or after the Maturity Date.
- (k) Investors will receive one distribution of income from the Trust. With that distribution, Investors will receive from the Trust an associated entitlement to the NRAS Offset received by the Trust as per paragraph 15(c) of this Product Ruling.
- (l) Investors will have their Units in the Trust redeemed by MFPML on the Maturity Date which is on or before the end of the income year, being 30 June. The term of the investment in the Trust will therefore be fixed for a period of approximately one month.

### **Loan Agreement**

- (m) The Loan Agreement will be between the Loan Provider and an Investor who takes out a Loan to finance their investment in the Trust.
- (n) The Loan will be limited recourse. Accordingly, any principal amount repayable by the Investor to the Loan Provider is limited to the Investor's Units and their proceeds.
- (o) The terms of the agreement in respect of the Loan are:
  - interest is paid in full in advance on the Drawdown Date;
  - the Interest Rate is fixed for the term of the Loan. The indicative Interest Rate will be available in the relevant Term Sheet and the actual Interest Rate will be noted in the Loan Confirmation provided by the Loan Provider; and
  - the agreement will end on the Maturity Date for each Offer, at which point the Loan is repaid using the Unit redemption proceeds.

- (p) The obligations of the Investor under the Loan Agreement in regard to the repayment of the Secured Moneys (which includes the Principal) will be secured by a Mortgage to be granted by the Investor in respect of the Mortgaged Property, which includes the Units held and all related rights as holder of those Units (including proceeds).
- (q) MFPML will grant a charge over the Deposit in favour of the Loan Provider as security for the Investors' obligations under their Loan Agreements with the Loan Provider. Under the Deposit Charge, the Loan Provider will only have recourse to the Deposit and not to any other assets of the Trust.

## Assumptions

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

- (a) the Investor is an Australian resident for taxation purposes;
- (b) the income year for the Trust will begin on 1 July of each year;
- (c) individual investors are not under a legal disability;
- (d) the Investor is not treated for taxation purposes as trading in the Units, carrying on a business of investing in the Units, or holding the Units as trading stock or as a revenue asset;
- (e) interest incurred on the Loan less the cost of the Put Option per paragraph 15(l) and an amount equal to the Participation Fee will not be greater than the sum of the amount assessable under paragraph 15(c) and the amount the Investor is entitled to under paragraph 15(d) of the Product Ruling;
- (f) the Investor will not repay the Loan prior to its relevant term or terminate the scheme prior to the Maturity Date;
- (g) the Trust will make a distribution of income to the Investor;
- (h) for the purposes of Division 380, the Consortium Agreements referred to in paragraph 16 of this Product Ruling establish an 'NRAS consortium' as per its definition in section 995-1;
- (i) the Approved Participant, if required, will make an election to receive the NRAS incentive as a tax offset certificate rather than a payment in accordance with the NRAS Regulations;

- (j) the Housing Secretary will issue an NRAS certificate in relation to each relevant NRAS year to the Approved Participant and it will not be withdrawn, revoked or otherwise cease to apply to the Participating Dwellings;
- (k) if required, the Approved Participant will make the relevant election under section 380-11;
- (l) the assignment of Rental Debts by an Approved Participant to the Trust is effective at law;
- (m) the scheme will be executed in the manner described in the scheme documentation referred to in paragraph 16 of this Product Ruling and in the Scheme section of this Ruling; and
- (n) all dealings between the Investor and Macquarie Group of companies including MFPML, the Depositholder and the Loan Provider will be at arm's length.

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**Commissioner of Taxation**2 April 2014

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## 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.*

### **Subsection 159GP(1) – a Unit in the Trust is not a 'security'**

21. Subsection 159GP(1) of the ITAA 1936 defines the term 'security'. Units in a unit trust will not be a security under paragraphs (a), (b) or (c) of the definition in subsection 159GP(1). Furthermore, units in a unit trust will not fall within the definition in paragraph (d) of subsection 159GP(1) unless there is a contract between the 'manager' of the unit trust (now commonly referred to as the responsible entity) and the unit holder under which there is a liability to pay an amount, and on the facts, the contract is found to be debt like (see paragraphs 4(ii) and 34 to 39 of Taxation Ruling TR 96/14).

22. A Unit in the Trust is not considered to be a contract between MFPML and the Investor (the unit holder), nor are the obligations between MFPML and the Investor considered to be debt like. Therefore, a Unit in the Trust does not meet the definition of security under subsection 159GP(1) of the ITAA 1936.

### **Division 6 – trust distributions**

23. Where a beneficiary who is not under a legal disability is presently entitled to a share of the income of a trust estate, paragraph 97(1)(a) of the ITAA 1936 requires the beneficiary to include in their assessable income that share of the trust's net income.

24. As a beneficiary of the Trust, the Investor is assessable under section 97 of the ITAA 1936 on so much of that share of the net income of the trust estate to which they are presently entitled. The Investor's present entitlement is reflected in their rights to receive income derived by the Trust in which the Investor has an interest, proportionate to the number of Units he or she holds in the Trust.

### **Division 380 - National Rental Affordability Scheme**

25. Division 380 of the ITAA 1997 provides a tax offset to a taxpayer that participates in the National Rental Affordability Scheme (NRAS). The amount of the tax offset is stated in the NRAS certificate issued by the Secretary of the Department of Social Services (Housing Secretary). A fixed tax offset is provided in respect of each dwelling where the conditions of the NRAS Act and the NRAS Regulations are met. The tax offset is indexed each year according to movements in the Rents component of the Housing Group Consumer Price Index.

26. An NRAS consortium is defined in subsection 995-1(1) to mean a consortium, joint venture or NEJV:

- (a) established by one or more contractual \*arrangements, the purpose of which are to facilitate the leasing of \*NRAS dwellings; and
- (b) that is not a \*corporate tax entity, a \*superannuation fund, a trust or a partnership.

27. A group of entities may form an NRAS consortium to collectively participate in the NRAS. A member of an NRAS consortium is eligible for a tax offset provided, inter alia, that the Housing Secretary issues a certificate to the approved participant of the NRAS consortium (subsection 380-14(1)). This is the entity that complies with the requirements of the NRAS Act and NRAS Regulations on behalf of the consortium.

28. The Trust is or will be a member of various NRAS consortia. The terms of each NRAS consortium are governed by a Consortium Agreement. Pursuant to the terms of each Consortium Agreement, the Trust will either lease Participating Dwellings from the owner and immediately after sub lease those dwellings to the Approved Participant of the NRAS consortium, or be assigned the Rental Debts in respect of the relevant Participating Dwellings by the Approved Participant.

29. Under the Consortium Agreements the Approved Participant will only receive the Annual Consortium Fees and Participation Fees if they have complied with the relevant provisions of the NRAS Act and NRAS Regulations.

30. Where an NRAS certificate is provided to the approved participant of an NRAS consortium, a member of that NRAS consortium will be deemed to have been issued with the certificate provided that the member derives NRAS rent from any of the NRAS dwellings covered by the certificate (section 380-14). Where the Trust is assigned the Rental Debts under the terms of a Consortium Agreement in respect of a Participating Dwelling, the Trust will derive NRAS rent.

31. NRAS rent is defined in subsection 995-1(1) as “rent derived from a NRAS dwelling under the National Rental Affordability Scheme for an income year.” Each of the Approved Participants under the Consortium Agreements including a lease structure are considered to derive NRAS rent because they are involved in all the key elements of the NRAS such as liaising with the Housing Secretary and dealing with eligible tenants to whom the NRAS dwellings are rented (see ATO Interpretative Decision ATO ID 2009/146). The approved participant of an NRAS consortium may choose to relinquish their entitlement to the tax offset in favour of another member of the NRAS Consortium (section 380-11). Where an election is made by an Approved Participant to relinquish its tax offset entitlement in favour of the Trust, section 380-13 deems the Trust’s rent under the Sub Lease to be NRAS rent.

32. Where an entity indirectly derives NRAS rent as a unit holder of a trust, they will be entitled to a tax offset (sections 380-15 and 380-25). Subsection 380-15(1) sets out the circumstances in which an entity to whom NRAS rent flows indirectly is entitled to a tax offset for an income year. The requirements of subsection 380-15(1) will be satisfied for an Investor where:

- (a) MFPML, as the responsible entity of the Trust, is deemed to have been issued with a NRAS certificate (paragraph 380-15(1)(a)), subject to the operation of section 380-14;
- (b) NRAS rent derived from any of the Participating Dwellings covered by the NRAS certificate flows indirectly to an Investor in each income year (paragraph 380-15(1)(b));
- (c) each offset year of the Trust (commencing on 1 July) will begin in each relevant NRAS year (ending 30 April of the following year) (paragraph 380-15(1)(c)); and
- (d) the Investor is one of the following entities (paragraph 380-15(1)(d)):
  - i. an individual; or
  - ii. a corporate tax entity when the NRAS rent flows indirectly to it; or
  - iii. the trustee of a trust that is liable to be assessed on a share of, or all or part of, the trust's net income under section 98,99 or 99A of the ITAA 1936 for the offset year; or
  - iv. the trustee of an FHSA.

33. Regarding the application of paragraph 380-15(1)(b), NRAS rent will flow indirectly to an Investor in the Trust because the Investor is required to include a share of the Trust's net income in their assessable income under paragraph 97(1)(a) of the ITAA 1936 (paragraph 380-25(3)(b)).

34. The amount of an Investor's entitlement to a tax offset is the sum of the amounts worked out using the following formula from subsection 380-15(2) for each NRAS dwelling from which NRAS rent is derived:

$$\text{Amount stated in the *NRAS certificate} \times \frac{\text{The entity's *share of the *NRAS rent for the *NRAS dwelling *derived during the *NRAS year}}{\text{Total *NRAS rent *derived during the *NRAS year from *NRAS dwellings covered by the *NRAS certificate}}$$

35. An Investor's share of NRAS rent for an income year is the amount notionally allocated to the Investor, whether or not the Investor actually receives any of that NRAS rent (subsection 380-30(2)). That amount is equal to so much of the NRAS rent as is taken into account in working out the Investor's share of the net income of the Trust (column 3 of the table at subsection 380-30(3)).

36. As the entire amount of NRAS rent derived by the Trust is taken into account in calculating its net income, and therefore the Investor's share of the net income, the effect of the formula is to entitle an Investor to a tax offset in proportion to their share of the net income of the Trust included in assessable income under paragraph 97(1)(a) of the ITAA 1936.

### **Section 8-1**

37. Interest paid on a borrowing used to acquire income producing assets, such as units in a unit trust, is generally treated as deductible under section 8-1 where it is expected that assessable income would be derived from the investment. However, where there is a disproportion between interest incurred and income produced, an apportionment of outgoings may be appropriate depending upon the extent to which the expenditure is devoted to the gaining or producing of assessable income (see Taxation Ruling TR 95/33).

38. In determining the relevant apportionment, the Investor will take into account the amount of income they receive from the Trust plus their share of tax offsets they receive under Division 380.

39. The Investor's cash position under the scheme is likely to be a cash negative position, taking into account the share of the income of the Trust plus the tax offsets that arise under Division 380 and therefore, for the purpose of section 8-1, the interest incurred on the Loan is required to be apportioned as outlined in subparagraph 15(e) of this Product Ruling.

### **Division 247 – capital protection**

40. 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.

41. Division 247 applies to a loan where the borrower uses the loan to acquire a unit and the borrower is protected against the fall in the market value of that unit (the protected thing).



42. An Investor enters into the Loan Agreement in order to acquire Units in the Trust. The Loan Provider's recourse against the Investor is limited to the amount which can be obtained by enforcing the rights relating to the Mortgaged Property (being the Units and their proceeds). Under the Scheme the Units could fall in market value if the Trust were to incur a loss and not be able to make a distribution of income, and the Investor does not receive any entitlements to tax offsets.

43. Therefore the Investor is wholly or partly protected against a fall in the market value of the acquired Units through the operation of the Loan Agreement. Where Units are redeemed by the Investor at Maturity, the limited recourse aspect of the Investment Loan means that the amount payable by the Investor to the Loan Provider is limited to the Investor's Units and their proceeds, and any amount recovered by the Loan Provider by enforcing the Deposit Charge.

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

45. Under the scheme, the amount reasonably attributable to the cost of capital protection afforded by the limited recourse provisions of the Loan is worked out according to the method statement in subsection 247-20(3) as set out in subparagraph 15 of this Product Ruling:

- (a) under step 1 of the method statement, the total amount of interest incurred by the Investor under the Loan for the income year is the interest incurred on the Loan for the income year less an amount equivalent to the Participation Fee referred to in paragraph 19(c) of this Product Ruling;
- (b) 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 a Put Option (subsection 247-20(6)); and
- (c) the Investor's Put Option is 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.

**Section 51AAA**

46. Under the scheme, it is contemplated that over the period of an Investor's involvement there will be assessable income derived by way of distributions of the net income of the Trust. As this income will be included in the assessable income of the Investor and is not as a result of a capital gain, section 51AAA of the ITAA 1936 has no application to the Investor.

**Section 82KL**

47. 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.

**Part 3-1 - application of CGT provisions to the Put Option**

48. If an Investor does not exercise the Put Option by the Maturity Date, the Put Option will expire (subsection 247-30(2)) and CGT Event C2 will happen under section 104-25.

49. As the investor will not receive any capital proceeds in respect of the expiry of the Put Option, a capital loss will be made by the investor in this regard, equal to the investor's reduced cost base of the Put Option.

50. The cost base and the reduced cost base of the Put Option will include the amount reasonably attributable to the cost of capital protection as calculated under Division 247 (subsections 110-25(2) and 110-55(2)).

**Part IVA – anti-avoidance**

51. Provided that the scheme ruled on is entered into and carried out as disclosed in this Ruling, it is accepted that the scheme is an ordinary commercial transaction and Part IVA will not apply.

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

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

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<i>Superannuation Industry (Supervision) Act 1993</i>	7
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## References

### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 95/33; TR 96/14

### *Subject references:*

- limited recourse loans
- product rulings
- public rulings
- taxation administration
- unit trust

### *Legislative references:*

- ITAA 1936 51AAA
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 6
- ITAA 1936 97
- ITAA 1936 97(1)(a)
- ITAA 1936 159GP(1)
- ITAA 1936 Sch 2F 272-5(3)
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 8-1
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 110-25(2)
- ITAA 1997 110-55(2)
- ITAA 1997 Div 247
- ITAA 1997 247-20(3)

- ITAA 1997 247-20(4)
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- ITAA 1997 380-13
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