


PR 2014/6 - Income tax: tax consequences for a Borrower under an Equities First Holdings loan

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Product Ruling

Income tax: tax consequences for a Borrower under an Equities First Holdings loan

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! This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

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 involves the procurement of a loan by the Borrower from Equities First Holdings, LLC (the Lender) pursuant to the terms of the Loan Agreement and the Deed of Security.
3. This Product Ruling does not address:
 - (a) the deductibility of interest incurred by the Borrower under the Loan Agreement pursuant to section 8-1;
 - (b) the treatment of any costs, fees and expenses (including borrowing expenses) payable by the Borrower under the scheme;
 - (c) a Borrower's requirement to withhold and remit Interest Withholding Tax;
 - (d) the assessability of the 'manufactured dividends' credited on behalf of, or paid to, the Borrower by the Lender in respect of the Secured Shares;
 - (e) whether the manufactured dividends carry franking credits, or a Borrower's entitlements to such franking credits;
 - (f) the exercise of the 'non-recourse option' by either the Borrower or the Lender;
 - (g) the Borrower's tax obligations and benefits in relation to the acquisition, holding and sale of an asset acquired with the principal sum borrowed under the Loan Agreement;
 - (h) an Event of Default or a Monetization Event;
 - (i) an assignment of the Loan Agreement and/or the Deed of Security by the Borrower; and

- (j) 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 Borrower.

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 35 of this Product Ruling on or after the date this Ruling is made and on or before 30 June 2016.

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

- (a) enter into this scheme before the date of this Ruling or after 30 June 2016;
- (b) trade in the Secured Shares and are treated for taxation purposes as trading in the Secured Shares, carrying on a business of investing in the Secured Shares, or holding the Secured Shares as trading stock or as revenue assets; or
- (c) 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 35 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 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 until 30 June 2016, 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 and the assumptions in paragraph 35 of this Ruling:

- (a) For the purposes of Part 3-1 and Part 3-3 (about capital gains and losses), a transfer of the Secured Shares by the Borrower to the Lender will be ignored pursuant to paragraph 106-60(1)(a). No CGT event will happen as a result of the vesting of the Secured Shares in the Lender.
- (b) Any sale and subsequent acquisition of the Secured Shares by the Lender during the Security Period will not be treated as acts done by the Borrower pursuant to subsection 106-60(2). No CGT event will happen in respect of the Borrower as a result of these acts.
- (c) A transfer of the Secured Shares by the Lender back to the Borrower after the end of the Security Period will not give rise to a CGT event.
- (d) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to the Borrower.

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 15 November 2013, 17 December 2013, 24 January 2014 and 13 February 2014;
- draft **Loan Agreement**, dated 11 February 2014; and
- draft **Deed of Security**, dated 11 February 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 are those that a Borrower will enter into. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Borrower, or any associate of a Borrower, 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 Loan Agreement and/or the Deed of Security.

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

Overview

19. Upon receipt of a successful application from the Borrower, a wholesale client for the purposes of the *Corporations Act 2001*, the Lender will make a loan facility available to the Borrower on and subject to the terms and conditions set out in the Loan Agreement. One of the conditions set out in the Loan Agreement is the Borrower's entry into the Deed of Security (as the Grantor) as security for their obligations and Liabilities as borrower under or in relation to the Loan Agreement.

20. On the Delivery Date, the Borrower shall transfer the Initially Secured Shares owned by the Borrower to the Lender (also acting as the Secured Party under the Deed of Security) as security for the discharge and performance of the Secured Obligations. To that end, the Borrower will procure the registration of the Initially Secured Shares in the name of the Lender by way of transfer to the Nominated EFH Securities Account.

21. Against this transfer, the Lender will promptly make an Initial Advance to the Borrower, before delivering the Remaining Loan Principal Amount to the Borrower on the Closing Date. The aggregate principal amount of the Loan made by the Lender to the Borrower will be equivalent to the LVR (loan to value ratio, expressed as a percentage and typically between 50% and 75%) of the Fair Market Value of the Initially Secured Shares.

22. There shall be no restrictions as to the purpose as to which the Loan may be applied by the Borrower.

23. Interest is payable by the Borrower on the Loan, as accrued, quarterly in arrears on each Interest Payment Date and on the Repayment Date.

24. The Borrower shall be entitled to receive from the Lender the benefit of all dividends, interest and other distributions that would, but for the transfer of the Secured Shares by way of security, have accrued or been payable to the Borrower as the registered owner of the Secured Shares during the Security Period. Any such distribution amount (referred to as manufactured dividends for the purposes of this Product Ruling) will be first credited by the Lender towards interest due by the Borrower under the Loan Agreement, before paying the balance of the manufactured dividends (if any) to the Borrower. To the extent the manufactured dividends are less than the interest due in respect of the relevant Interest Period, the Borrower remains obligated to pay the balance to the Lender in accordance with the Loan Agreement.

25. The Lender may, during the Security Period, combine the Secured Shares with other assets and/or sell, buy and otherwise deal with the Secured Shares, and has no obligation to apply money or funds received in respect of any such dealing in the Secured Shares towards the Secured Moneys. The Lender will not, however, whether directly or indirectly, engage in short-selling or front-running in respect of the Secured Shares.

26. If at any time the Lender has a Margin Ratio Exposure in respect of the Borrower, meaning the ratio of the Fair Market Value of the Secured Shares to the Loan has fallen below the Margin Ratio of 80%, the Lender may deliver a Margin Call to the Borrower requiring the Borrower to make a Margin Transfer to the Lender of an aggregate amount or value so that, following such Margin Transfer, the Fair Market Value of the Secured Shares plus the value of the Margin Transfer is equal to or exceeds the Margin Ratio.

27. The Borrower shall have five Business Days commencing on the date the Margin Call is delivered to make the Margin Transfer and cure the Margin Ratio Exposure. This means transferring sufficient Margin Cash or Margin Securities, as directed by the Lender.

28. Any Margin Cash paid to the Lender pursuant to the Margin Call shall be applied by the Lender to reduce the Loan. Any Margin Securities delivered to and registered in the name of the Lender pursuant to a Margin Call shall become part of the Secured Shares and therefore subject to the Deed of Security, held by the Lender as security for the discharge and performance of the Secured Obligations.

29. The Borrower may request, and the Lender may provide, further loans to the Borrower secured against additional tranches of Reference Securities, recorded by the parties signing and dating a Tranche Loan Agreement.

30. Subject to an event which may give rise to an early repayment of the Loan (as per paragraph 31 of this Product Ruling), the Borrower must repay the Loan to the Lender in full on the Repayment Date, together with all other Secured Moneys payable and unpaid at the time. Voluntary repayment of the Loan prior to the Repayment Date is not permitted.

31. Subject to the exercise of the non-recourse option discussed at paragraph 34 of this Product Ruling, the Borrower must repay the Loan, together with all other Secured Moneys payable and unpaid at the time, to the Lender in full:

- where immediate repayment is demanded by the Lender following an Event of Default and during a Continuing Default; or
- on the Early Repayment Date where the Secured Shares are subject to a Monetization Event.

32. After the end of the Security Period the Lender shall, at the request and cost of the Borrower, transfer the Secured Shares back to the Borrower or as the Borrower may direct and otherwise to release the Security.

33. Where the Security has become enforceable following the occurrence of an Event of Default and the Lender, having served an Enforcement Notice on the Borrower, wishes to enforce all or any part of the Security and sell or otherwise dispose of the Secured Property, or any part of it, the Lender shall be entitled to apply the proceeds of such sale or other disposal in or towards the discharge of the Secured Obligations.

34. Each party to the Deed of Security may (but is not obliged to) on or following the service of an Enforcement Notice by the Lender, exercise the non-recourse option by giving a Non-recourse Notice to the other party. In the event that a Non-recourse Notice is served by either the Borrower or the Lender (in their capacities as Grantor and Secured Party respectively) under the provisions of the Deed of Security:

- the Borrower shall be under no liability to the Lender in respect of the Loan and the Secured Obligations;
- the Security Period shall be deemed to be at an end and the Lender shall have no further liability to retransfer the Secured Shares to the Borrower (as per paragraph 32 of this Product Ruling); and
- neither the Lender nor the Borrower shall be liable to the other in respect of any deficit or excess (as the case may be) in the value or sale price of the Secured Shares as against the Secured Moneys.

Assumptions

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

- (a) the Borrower is an Australian resident for taxation purposes;
- (b) the Borrower is an individual, corporation or trust (but is not a superannuation fund);
- (c) the Secured Shares are listed on the Australian Securities Exchange;
- (d) the Borrower holds their Secured Shares on capital account prior to the point when they are transferred to the Lender, is not a trader in the Secured Shares and is not treated for taxation purposes as trading in the Secured Shares, carrying on a business of investing in the Secured Shares, or holding the Secured Shares as trading stock or a revenue asset;
- (e) the Borrower is not subject to Division 230 in respect of this scheme;
- (f) the Loan will have a term of two years or more;

- (g) clause 7.2 of the Deed of Security, permitting the Lender to, inter alia, sell, buy and otherwise deal with the Secured Shares (as per paragraph 25 of this Product Ruling), is valid pursuant to Australian law;
- (h) all dealings between the Borrower and the Lender will be at arm's length; and
- (i) the scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation referred to in paragraph 16 of this Ruling.

Commissioner of Taxation

2 April 2014]

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 106-60(1) – transfer of Secured Shares

36. Pursuant to subsection 104-10(2), a taxpayer is considered to have disposed of a CGT asset if a change of ownership has occurred from the taxpayer to another entity, whether because of some act or event or by operation of law. Whilst such a disposal generally gives rise to a CGT event A1 for the taxpayer (subsection 104-10(1)), paragraph 106-60(1)(a) ignores the vesting of an asset in a security holder, ensuring that, for the purposes of the capital gains tax provisions, the security provider is still treated as the owner of the asset.

37. Paragraph 106-60(1)(a) provides as follows:

106-60(1)

For the purposes of this Part and Part 3-3 (about capital gains and losses) and Subdivision 328-C (What is a small business entity):

(a) the vesting of a *CGT asset in an entity is ignored, if:

(i) the vesting is for the purpose of enforcing, giving effect to or maintaining a security, charge or encumbrance over the asset; and

(ii) the security, charge or encumbrance remains over the asset just after the vesting; and

38. The transfer of the Secured Shares (both in the form of the Initially Secured Shares and the Margin Securities) by the Borrower (the security provider) to the Lender (the security holder) constitutes a vesting of those CGT assets in the Lender for the purpose of giving effect to or maintaining, as the case may be, a security over the Secured Shares under the terms of the Deed of Security, and that security will remain over the Secured Shares 'just after the vesting'.

39. As paragraph 106-60(1)(a) will ignore the vesting of the Secured Shares in the Lender upon their transfer by the Borrower to the Lender, treating the Secured Shares as though they continue to be owned by the Borrower, such transfer will not constitute an acquisition or disposal of the Secured Shares and no CGT event (including CGT event A1) will happen.

40. Similarly, as paragraph 106-60(1)(a) will ignore the vesting of the Secured Shares in the Lender upon their transfer by the Borrower to the Lender, treating the Secured Shares as though they continue to be owned by the Borrower, any retransfer of the Secured Shares by the Borrower from the Lender as a result of the Security Period coming to an end will not constitute an acquisition or disposal of the Secured Shares and no CGT event (including CGT event A1) will happen (paragraph 1.34 of the Explanatory Memorandum to the Tax Laws Amendment (2013 Measures No. 1) Bill 2013).

Subsection 106-60(2) – sale and acquisition of Secured Shares by the Lender

41. Subsection 106-60(2) treats certain acts done by the security holder (or their agent) in relation to a CGT asset as being done by the security provider which, in conjunction with the operation of subsection 106-60(1)(a), ensures that all capital gains tax consequences in respect of the relevant assets rest with the security provider (as the underlying owner), rather than with the security holder.

42. Subsection 106-60(2) reads as follows:

106-60(2)

This Part, Part 3-3 and Subdivision 328-C apply to an act done by an entity (or an *agent of the entity) in relation to a *CGT asset for the purpose of enforcing, giving effect to or maintaining a security, charge or encumbrance over the asset as if the act had been done by the entity that provided the security (instead of by the first-mentioned entity or its agent).

43. Importantly, subsection 106-60(2) only applies to acts done 'for the purpose of enforcing or giving effect to or maintaining a security, charge or encumbrance over the asset', and does not apply where a security holder does an act in relation to a CGT asset that is not for this purpose.

44. The Lender's act of selling and subsequently acquiring some or all of the Secured Shares during the Security Period (as permitted in accordance with paragraph 25 of this Product Ruling) is not done for the purpose of enforcing or giving effect to or maintaining a security over the Secured Shares under the terms of the Deed of Security, but for the purpose of deriving a profit on its own account.

45. The requisite purpose set out in subsection 106-60(2) is therefore not satisfied such that those particular acts done by the Lender will not be treated as acts done by the Borrower and will not give rise to a CGT event for the Borrower.

Part IVA – anti-avoidance

46. 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 of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

- capital gains tax
- financial products
- income tax
- product rulings
- public rulings
- tax administration

- ITAA 1997 104-10(1)
- ITAA 1997 104-10(2)
- ITAA 1997 Pt 3-1
- ITAA 1997 106-60(1)
- ITAA 1997 106-60(1)(a)
- ITAA 1997 106-60(2)
- ITAA 1997 Pt 3-3
- ITAA 1997 Div 230
- TAA 1953
- Corporations Act 2001
- Tax Laws Amendment (2013 Measures No. 1) Bill 2013

Legislative references:

- ITAA 1936 Pt IVA
- ITAA 1997

ATO references

NO:	1-55I0AEH
ISSN:	1441-1172
ATOlaw topic:	Income Tax ~~ Product ~~ finance

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