


PR 2018/14 - Income tax: taxation consequences of investing in the Macquarie Tailored Portfolio Collar Facility

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Product Ruling

Income tax: taxation consequences of investing in the Macquarie Tailored Portfolio Collar Facility

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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, 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 referred to as the Tailored Portfolio Collar Facility (the Facility) offered by Macquarie Bank Limited (the Bank) and issued under the Product Disclosure Statement referred to in paragraph 15 of this Product Ruling (the PDS).
3. This Product Ruling does not address:
 - the taxation consequences associated with a Linked Loan to the extent that it is used for purposes other than to fund the acquisition of Reference Assets
 - the taxation consequences associated with any loan used to fund the acquisition of Reference Assets, other than a Linked Loan
 - the taxation consequences of fees and charges paid to the Bank in respect of the Facility, except for any Fixed Premium and Variable Premium (together referred to as the 'Option Premium' for the purpose of this Product Ruling) and interest charged in respect of a Linked Loan and an Interest Assistance Loan
 - the assessability of income derived by an Investor from the Reference Assets
 - an Investor's entitlement to franking credits
 - the taxation consequences of an early termination of an Option, Linked Loan or Interest Assistance Loan (whether upon the occurrence of an Early Termination Event, a Loan Acceleration Event or an Option Acceleration Event, or at an Investor's request)
 - the taxation consequences to arise if the Bank waives some or all of the Variable Premium payable

- the taxation consequences of a transfer of Reference Assets to or from the Nominee in accordance with the Nominee Terms
- the taxation consequences of an assignment or transfer of an Investor's interest under the Facility
- the taxation consequences of rolling a Cash Settlement Request into another Option
- the taxation consequences of any transactions entered into as a result of a corporate action, including a Potential Adjustment Event, and
- 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. Those entities that can rely on the Ruling section are referred to in this Product Ruling as the Investor.

5. The class of entities that can rely on the Ruling section of this Product Ruling consists of those entities that:

- enter into the scheme described in paragraphs 15 to 19 of this Product Ruling on or after 1 July 2018 and on or before 30 June 2021
- at the time of entering into the scheme and on each Interest Payment Date thereafter, 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), and
- at the time of entering into the scheme, have a genuine intention and realistic expectation of deriving assessable income (other than capital gains) from the investment that exceeds the deductible expenditure incurred in connection with the investment.

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

- are accepted to participate in the scheme described in paragraphs 15 to 19 of this Product Ruling before 1 July 2018 or after 30 June 2021
- at the time of entering into the scheme and on each Interest Payment Date thereafter, intend to terminate their involvement in the scheme prior to its completion

- at the time of entering into the scheme, do not have a genuine intention and realistic expectation of deriving assessable income (other than capital gains) from the Reference Assets that exceeds the deductible expenditure that they incur in order to invest in the scheme
- trade in Reference Assets and/or other financial investments and are treated for taxation purposes as trading in Reference Assets, carrying on a business of investing in Reference Assets, or holding Reference Assets as trading stock or as revenue assets
- trade in Options and/or other financial investments and are treated for taxation purposes as trading in the Options, carrying on a business of investing in Options, or holding the Options as trading stock or as revenue assets
- 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
- do not satisfy an assumption set out in paragraph 19 of this Product Ruling, or
- are subject to Division 230 in respect of this scheme.

Qualifications

7. 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 15 to 19 in this Product Ruling.

8. 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

9. This Product Ruling applies from 1 July 2018. It therefore applies only to the specified class of entities that enter into the scheme from 1 July 2018 until 30 June 2021, 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.

10. 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

11. 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.

12. 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

13. 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

14. Subject to paragraph 3 of this Product Ruling and the assumptions in paragraph 19 of this Ruling:

- (a) Where an Investor acquires an Option together with a Linked Loan:

- (i) under step 3 of the method statement in subsection 247-20(3), the amount reasonably attributable to the cost of capital protection under Division 247 in an income year is the amount by which the total of any Option Premium and the interest incurred under the Linked Loan for the income year exceeds the amount of the Linked Loan multiplied by the sum of the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans – Investor and 100 basis points (the 'adjusted loan rate') at the time when the interest charge is first incurred during the term of the Linked Loan, or the relevant part of the term (subsections 247-20(4) and (5))
 - (ii) the amount reasonably attributable to the cost of capital protection under Division 247, as worked out under paragraph 14(a)(i) of this Product Ruling, reduced by the amount of any Option Premium paid by an Investor, is treated as a further cost of the Option granted by the Bank to the Investor under subsection 247-20(6). For the purposes of this Product Ruling, this further cost of the Option is referred to as 'the additional amount'
 - (iii) the additional amount (if any) and any Option Premium paid by an Investor are not deductible under section 8-1, and
 - (iv) an amount equal to the interest incurred by an Investor under the Linked Loan, reduced by the additional amount (if any), will be deductible under section 8-1.
- (b) Division 247 will not apply to the Interest Assistance Loan. An amount equal to the interest incurred under the Interest Assistance Loan will be deductible under section 8-1.
- (c) Section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny an Investor a deduction for the interest incurred under the Linked Loan and the Interest Assistance Loan (if applicable) that is allowable as a deduction under section 8-1 of the ITAA 1997.
- (d) Section 82KL of the ITAA 1936 will not apply to deny the amount of interest incurred under the Linked Loan and the Interest Assistance Loan (if applicable) that is allowable as a deduction under section 8-1 of the ITAA 1997.

- (e) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the prepaid interest incurred under the Linked Loan that is allowable as a deduction under section 8-1 of the ITAA 1997.
- (f) Section 82KZM of the ITAA 1936 will not apply to deny an Investor immediate deductibility of any part of the prepaid interest incurred under the Linked Loan that is allowable as a deduction under section 8-1 of the ITAA 1997, where at least one of the following applies for the year of income:
 - (i) the Investor is a small business entity (as defined in subsection 328-110(1) of the ITAA 1997) that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or
 - (ii) the Investor is an individual who does not incur the interest in carrying on a business.
- (g) Section 82KZMA and section 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the prepaid interest incurred under the Linked Loan that is allowable as a deduction under section 8-1 of the ITAA 1997 to an Investor (other than a small business entity for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure) that is a taxpayer that is not an individual and does not carry on a business.
- (h) Subject to paragraph 14(j)(ii) of this Product Ruling, the cost base and reduced cost base of the Reference Assets acquired by an Investor will include the amount of the Linked Loan (if any) used to finance the Reference Assets and incidental costs of acquisition and disposal of the Reference Assets: sections 110-25 and 110-55.
- (i) For CGT purposes, the date of acquisition of the Reference Assets is the date on which an Investor acquired the Reference Assets: section 109-5.
- (j) If the Final Portfolio Reference Price is less than the Portfolio Protection Price on the Expiry Date and the Option is exercised by an Investor under a Sell Instruction:
 - (i) CGT event A1 under section 104-10 will happen in relation to the Reference Assets for the Investor

- (ii) pursuant to subsection 134-1(1), the cost base and reduced cost base of the Reference Assets will include any Fixed Premium paid and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling, and
 - (iii) any capital gain or capital loss made by the Investor on exercise of the Option will be disregarded under subsection 134-1(4).
- (k) If the Final Portfolio Reference Price is less than the Portfolio Protection Price on the Expiry Date and the Option is exercised by an Investor under a Cash Settlement Request:
 - (i) CGT event C2 under paragraph 104-25(1)(e) will happen in relation to the Option for the Investor, and
 - (ii) pursuant to sections 110-25 and 110-55, the cost base and the reduced cost base of the Option will include any Fixed Premium paid and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling.
- (l) If the Final Portfolio Reference Price is less than the Portfolio Protection Price on the Expiry Date, the Option is not exercised by an Investor and they receive an Assessed Value Payment:
 - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the Option for the Investor, and
 - (ii) pursuant to sections 110-25 and 110-55, the cost base and the reduced cost base of the Option will include any Fixed Premium paid and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling.
- (m) If the Final Portfolio Reference Price is greater than or equal to the Portfolio Protection Price on the Expiry Date, each Reference Asset in the Portfolio is less than its Cap Price and the Option expires unexercised:
 - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the Option for the Investor, resulting in a capital loss equal to the reduced cost base of the Option under subsection 104-25(3), and
 - (ii) pursuant to section 110-55, the reduced cost base of the Option will include any Fixed Premium paid and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling.

- (n) If the Final Portfolio Reference Price is greater than or equal to the Portfolio Protection Price on the Expiry Date, at least one Reference Asset in the Portfolio is greater than its Cap Price and the Option expires unexercised:
 - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the Option for the Investor, resulting in a capital loss equal to the reduced cost base of the Option under subsection 104-25(3), and
 - (ii) pursuant to section 110-55, the reduced cost base of the Option will include any Fixed Premium and Variable Premium paid, and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling.
- (o) If an Investor sells (or arranges for the sale of) the Reference Assets under a Sell Instruction to fund the repayment of a Linked Loan, CGT event A1 will happen under section 104-10 in relation to the Reference Assets for the Investor.
- (p) Any capital gain made by an Investor on disposal of the Reference Assets, exercise of the Option under a Cash Settlement Request or expiry of an Option in circumstances resulting in the receipt of an Assessed Value Payment will be treated as a discount capital gain pursuant to section 115-5 where the Investor is an individual or a trust and the Investor acquired the Reference Assets or Option (as applicable) at least 12 months before the disposal, exercise or expiry.
- (q) Division 230 will not apply to any gains or losses with respect to the Facility where an Investor is excepted from the Division pursuant to section 230-455.
- (r) The anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny the deductibility of the interest incurred by an Investor in respect of the Linked Loan or the Interest Assistance Loan (if applicable).

Scheme

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

- application for a Product Ruling as constituted by documents and information received on 22 June 2018 and 9 October 2018

- the Macquarie Tailored Portfolio Collar Facility Product Disclosure Statement dated 23 May 2011, as updated on 10 April 2014 and 1 July 2014 (the PDS)
- the Macquarie Tailored Portfolio Collar Facility Terms and Conditions dated 23 May 2011, as updated on 10 April 2014 and 1 November 2015 (the Terms and Conditions), and
- the Tailored Portfolio Collar Facility Additional Security Deed, received on 9 October 2018.

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

16. For the purposes of describing the scheme to which this Product 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. Capitalised terms in this Product Ruling take their meaning from the PDS and/or the Terms and Conditions referred to in paragraph 15 of this Product Ruling.

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

Overview

18. The details of the Facility are summarised as follows:

- (a) The Facility allows an Investor (constituting an individual, company or trustee of a trust, but not a superannuation fund) to gain exposure to one or more Portfolios of Reference Assets and to:
 - (i) protect the value of their investment in each Portfolio at a future time and at a specified value by acquiring an Option from the Bank
 - (ii) borrow from the Bank under an optional loan that is linked to each Option that the Investor acquires (a Linked Loan), and
 - (iii) borrow from the Bank under an optional loan to prepay interest due in relation to the Linked Loan (an Interest Assistance Loan).

- (b) An Investor must complete and sign the Application Form. Upon acceptance by the Bank of an Investor's Application Form, the Investor is bound by the Terms and Conditions and can make a Transaction Request to apply for one or more Options, one or more Linked Loans and/or one or more Interest Assistance Loans. After the receipt of a Transaction Request and any further instructions from the Investor or their financial adviser (if nominated), the Bank will execute the transaction and issue a Confirmation that confirms some or all of the terms of one or more Options or Loans requested by the Investor.
- (c) An Investor can make a Transaction Request to apply for one or more Options by specifying:
 - (i) the number (or value) and type of Reference Assets to be included in the Portfolio for their Options
 - (ii) the Portfolio Protection Price (or a percentage equivalent of the Initial Portfolio Reference Price), which is the price at which the value of the Investor's investment in the Portfolio is protected on expiry of the Options
 - (iii) a Cap Price for all the Reference Assets in the Portfolio (or a percentage equivalent of the Initial Reference Price for each Reference Asset), if any, which is the price at which the value of the Investor's investment in a given Reference Asset in the Portfolio is capped, and
 - (iv) the desired Expiry Date of their Options.
- (d) An Investor may be required to pay the Bank a Fixed Premium for the Option on one or more Fixed Premium Payment Dates. The Fixed Premium is based on a range of factors including the selected Reference Assets, the Portfolio Protection Price and Cap Price (if any), the volatility of the price of the Reference Assets, future expected dividends and distributions of the Reference Assets and the term of the Option.
- (e) To reduce the Fixed Premium for an Option, an Investor can elect to set a Cap Price for each Reference Asset in the Portfolio. By setting a Cap Price for each Reference Asset in the Portfolio, the Investor agrees to pay the Bank an additional amount at the expiry of the Option (the Variable Premium) equal to the amount (if any) by which each Reference Asset in the Portfolio exceeds its Cap Price (assuming the value of the Portfolio as a whole exceeds the Portfolio Protection Price on expiry). In some

circumstances the Bank may waive some or all of the Variable Premium payable by the Investor.

- (f) Options are available in relation to a wide variety of Reference Assets, including ASX-listed securities and units in trusts that are unlisted managed investment schemes, as defined in section 9 of the *Corporations Act 2001* and registered under section 601EB of that Act (including units in an approved cash trust), that an Investor either already holds or acquires using a Linked Loan under the Facility. An approved cash trust means a managed investment scheme which invests in short-term cash deposits, short-term money market and floating rate securities, annuities and cash equivalent securities issued by entities (including, potentially, the Bank), as determined by the Bank from time to time.
- (g) An Investor may select their own combination of Reference Assets to form a Portfolio, but no more than 50% of the market value of the Portfolio selected by the Investor may consist of units in a managed investment scheme (including units in an approved cash trust).
- (h) The Portfolio of Reference Assets that an Investor wishes to protect under an Option must have an initial market value (as determined by the Bank) of at least \$1 million (or a lesser amount at the Bank's discretion), with a minimum market value (as determined by the Bank) of \$125,000 for each type of Reference Asset (or a lesser amount at the Bank's discretion). The investment term for an Option may be from six months up to five years (with shorter or longer terms available at the Bank's discretion).
- (i) An Investor can make a Transaction Request to apply for one or more Linked Loans by specifying:
 - (i) the Option(s) to which the Linked Loan will be linked (the Linked Option(s))
 - (ii) the amount of the Linked Loan, which should be greater than or equal to \$50,000 and less than or equal to the Available Loan Balance (with higher or lower amounts at the Bank's discretion)
 - (iii) the Interest Rate and Interest Payment Date(s), as previously discussed with the Bank
 - (iv) the Commencement Date and the Repayment Date (which must be no later than the Expiry Date of the Linked Option(s)), and

- (v) that the proceeds of the Linked Loan will be used wholly or predominantly for business or investment purposes (other than investment in residential property).
- (j) The Bank will calculate a fixed rate of interest for the Linked Loan. The Interest Rate will be quoted and reported to an Investor taking into account all of the Reference Assets held by the Investor under the Facility and the term of the loan. Generally, the shorter the period of the Linked Loan and the greater the risk to the Bank given the security offered by the Reference Assets, the higher the rate of interest charged. The inclusion in the Portfolio of Reference Assets of units in an approved cash trust will result in a lower Interest Rate on the Linked Loan compared to a portfolio of Reference Assets which does not include units in an approved cash trust.
- (k) Where the investment involves a combination of a Linked Loan and an Option entered into at the same time:
 - (i) the interest an Investor pays may include some or all of the cost of protection provided by the Option, and
 - (ii) generally, to reduce its credit risk on the Investor, the Bank limits any shortfall between the Linked Loan amount and the Portfolio Protection Price to a maximum of 5% of the Initial Portfolio Reference Price.
- (l) An Investor must pay interest on the amount of each Linked Loan in advance on each Interest Payment Date (as agreed by the Investor and the Bank), and the interest may, with the Bank's consent, be capitalised into the Linked Loan or paid by using the Interest Assistance Loan. The Investor must repay the Linked Loan on its Repayment Date.
- (m) An Investor can make a Transaction Request to apply for one or more Interest Assistance Loans. An Interest Assistance Loan must:
 - (i) be used by an Investor to prepay all or part of the interest due in relation to the Linked Loan on a given Interest Payment Date
 - (ii) have a maximum term of 12 months
 - (iii) have a fixed interest rate, and
 - (iv) be repaid with principal and interest payments monthly in arrears, on each IAL Repayment Date.

- (n) To secure an Investor's obligations under the Facility, including those under a Linked Loan and an Interest Assistance Loan (each being full recourse), the Investor:
 - (i) is required to mortgage the Secured Property in favour of the Bank in accordance with the Security Arrangements each time that the Investor enters into an Option
 - (ii) may be required to hold any Secured Property for an Option that is an ASX Security in the CHESS Account established for the Investor with the Sponsor, in accordance with the Sponsorship Agreement, and
 - (iii) may be required to agree to further security arrangements required under the Bank's standard lending policies, as documented in an Additional Security Deed between the Bank and the Investor.

The Secured Property consists of the Reference Assets in the Portfolio for that Option, Accretions arising in relation to the Reference Assets (including dividends, distributions, bonus shares and rights) and all the Investor's rights in relation to the Reference Assets and the Accretions.

- (o) Subject to application of the Nominee Terms (discussed in this paragraph), an Investor will at all times hold the legal and beneficial interest in the Reference Assets and accordingly may, by agreement with the Bank, direct that dividends and distributions paid in respect of the Reference Assets be applied to repay principal or interest on the Linked Loan or the Interest Assistance Loan (if applicable). The Bank may, under certain security arrangements in respect of corporate actions, cause legal title to the Reference Assets and Accretions included in the Secured Property to be held by the Nominee, as the Investor's nominee in accordance with the Nominee Terms.
- (p) On the Expiry Date of an Option, if an Investor has provided to the Bank a Sell Instruction for the Option no later than five Scheduled ASX Business Days before the Option's Expiry Date, the Investor is choosing to sell the Portfolio of Reference Assets for that Option at their Final Reference Price. In that instance, if the Final Portfolio Reference Price of the Portfolio is:
 - (i) equal to or above the Portfolio Protection Price, the Investor will receive an amount equal to the Final Portfolio Reference Price for that Portfolio

- (less any Variable Premium payable if the Final Reference Price of any Reference Asset exceeds its Cap Price), or
- (ii) less than the Portfolio Protection Price, the Investor will receive an amount equal to the Portfolio Protection Price for that Portfolio.
- (q) Alternatively, an Investor may, on the Expiry Date of an Option, provide to the Bank a Cash Settlement Request for the Option, in which case the Investor chooses to keep the Portfolio of Reference Assets for the Option and to receive a Cash Settlement Amount. Where the Final Portfolio Reference Price is less than the Portfolio Protection Price, the Cash Settlement Amount paid to the Investor is calculated as the amount by which the Portfolio Protection Price exceeds the Final Portfolio Reference Price. Where the Final Portfolio Reference Price is equal to or above the Portfolio Protection Price, the Cash Settlement Amount is zero.
- (r) The receipt of any Cash Settlement Amount or disposal proceeds following a Sell Instruction is subject to an Investor having paid any outstanding amounts to the Bank, including any Variable Premium.
- (s) If an Investor fails to give the Bank a Cash Settlement Request or Sell Instruction in relation to an Option by the Expiry Date of the Option and the Final Portfolio Reference Price is less than the Portfolio Protection Price, the Option will lapse and the Investor will only be entitled to receive an Assessed Value Payment in relation to that Option. The Assessed Value Payment is equal to 95% of the Cash Settlement Amount that the Investor would have received had they given a Cash Settlement Request for that Option.
- (t) In the event that an Investor defaults in payment of fees and other costs owed under the Facility an Early Termination Event will occur. If an Early Termination Event occurs, any Options may terminate or lapse early, any Linked Loans and Interest Assistance Loans will be immediately due and payable and the Bank may dispose of some or all of the Secured Property and receive all monies arising from that disposal to pay the Early Termination Amount.
- (u) The Bank may pay a fee to an Investor's adviser in respect of an Option and/or a Linked Loan, and will disclose any such fee to the Investor. In this case, the Fixed Premium payable by the Investor and/or the Interest Rate charged on a Linked Loan (as relevant) is likely to be higher than if the Bank did not pay a fee to the adviser.

Assumptions

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

- (a) The Investor is an Australian resident for taxation purposes.
- (b) The Investor will not make an election under subsection 230-455(7) to have Division 230 apply.
- (c) The Investor will not draw down on any Linked Loan for any purpose other than to fund the acquisition of Reference Assets.
- (d) Where a Linked Loan is utilised, the Reference Assets acquired will not consist of an Asset other than shares, units or Stapled Securities.
- (e) Where a Linked Loan is utilised and the Reference Assets consist of shares, on each Interest Payment Date those shares satisfy the requirements of subparagraph 82KZME(5)(b)(ii) of the ITAA 1936.
- (f) Where a Linked Loan is utilised and the Reference Assets consist of units in a trust, on each Interest Payment Date the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936.
- (g) Where a Linked Loan is utilised and the Reference Assets consist of a Stapled Security, on each Interest Payment Date the Stapled Security comprises shares and/or units that satisfy the requirements of subparagraph 82KZME(5)(b)(ii) of the ITAA 1936 and subparagraph 82KZME(5)(b)(iii) of the ITAA 1936, as applicable.
- (h) The Reference Assets are not ESS interests to which Subdivision 83A-B or 83A-C (about employee share schemes) applies.
- (i) The dominant purpose of the Investor in entering into the scheme is to derive an amount of receipts (income, gains and distributions) from their Reference Assets acquired under the scheme that exceeds the total expenses incurred in respect of the Facility.
- (j) The Investor will hold their interests in the Reference Assets on capital account, are not traders in Reference Assets and are not treated for taxation purposes as trading in the Reference Assets, carrying on a business of investing in the Reference Assets, or holding the Reference Assets as trading stock or as a revenue asset.

- (k) The Investor will hold the Options on capital account, are not treated for taxation purposes as trading in Options, carrying on a business of investing in Options, or holding the Options as trading stock or a revenue asset.
- (l) Interest to be paid in advance under a Linked Loan will be prepaid only in relation to a Linked Loan Interest Period of 12 months or less, and which ends on or before the last day of the income year following the expenditure year.
- (m) The scheme will be executed in the manner described in the scheme documentation and in the Scheme section of this Product Ruling.
- (n) All dealings between the Investor, the Bank and other members of the Macquarie Group will be at arm's length.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Section 8-1 and Division 247 – capital protected borrowings and deductibility of interest

20. Interest paid on a borrowing used to acquire income producing assets such as a Reference Asset is generally 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 *Income tax: subsection 51(1) – relevance of subjective purpose, motive or intention in determining the deductibility of losses and outgoings*). However, the ability to claim interest deductions may be subject to Division 247.

21. 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.

22. Division 247 applies to the Linked Loan where the Investor uses the Linked Loan to acquire the Reference Assets and the Investor is protected against the fall in the market value of those Reference Assets.

23. 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, pursuant to subsection 247-20(3).

24. Where an Investor acquires an Option and procures a Linked Loan:

- the cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in paragraph 14(a)(i) of this Product Ruling
- under step 1 of the method statement, the total amount incurred by the Investor under or in respect of the Linked Loan for the income year is the interest incurred on the Linked Loan and any amounts that are in substance for capital protection (that is, any Option Premium) for the income year

- 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 Linked Loan will be fully deductible under section 8-1
- 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 of the Option (as per paragraph 14(a)(ii) of this Product Ruling), the amount reasonably attributable to the cost of capital protection will be reduced by the actual payment for an Option (any Option Premium) 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 any Option Premium paid by the Investor, and
- the Investor's Option is a capital asset. Therefore, any Option Premium paid and the additional amount (if any) is capital in nature and not deductible under section 8-1.

25. Where an Investor has acquired a Portfolio and the Bank has applied a single Interest Rate to the Linked Loan, the investment will be treated as one arrangement for the purposes of Division 247.

26. There is no element of capital protection connected with the Interest Assistance Loan. No part of the interest incurred by an Investor on an Interest Assistance Loan for the income year will therefore be attributable to the cost of capital protection and the interest on the Interest Assistance Loan will be deductible under section 8-1.

Section 51AAA

27. By acquiring the Reference Assets, it is contemplated that an Investor will derive assessable income by way of the receipt of dividends and/or trust distributions and capital gains. As interest incurred on any Linked Loan and Interest Assistance Loan would have been deductible under section 8-1 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to an Investor who enters into the Facility.

Section 82KL

28. The operation of section 82KL of the ITAA 1936 depends on, among other things, the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

Subdivision H of Division 3 of Part III

29. Subdivision H of Division 3 of Part III of the ITAA 1936 (Subdivision H) deals with the timing of deductions for certain advance expenditure incurred under an agreement in return for the doing of a thing under that agreement that will not be wholly done within the same year of income. Separate rules apply depending on whether the expenditure is incurred in carrying on a business, whether the Investor is a small business entity, whether the Investor is an individual and whether the Investor is not an individual and incurs the expenditure otherwise than in carrying on a business. This Subdivision does not apply to 'excluded expenditure' which is defined in subsection 82KZL(1) of the ITAA 1936 to include amounts of less than \$1,000 or amounts that are of a capital nature.

Subdivision 328-C – small business entities for the purposes of Subdivision H

30. Under section 328-110, an Investor carrying on a business in an income year will be a small business entity for that year (the current year) if:

- the Investor carried on a business in the previous income year and the aggregated turnover for that year was less than \$10 million
- the aggregated turnover for the current year is likely to be less than \$10 million and, where the Investor carried on a business in each of the two previous income years, the aggregated turnover for each of those income years was less than \$10 million, or
- the aggregated turnover for the current year, worked out as at the end of the year is less than \$10 million.

The eligible service period for the purposes of Subdivision H

31. The interest charged on a Linked Loan that is deductible under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is 12 months or less.

Paragraph 82KZL(2)(a) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principal is to be taken, for the purposes of Subdivision H, to be expenditure incurred under an agreement in return for the doing of a thing under the agreement for the period to which the interest payment relates. The eligible service period in relation to a payment of loan interest is determined by reference to the period to which the interest relates and not to the period of the loan.

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

32. 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.

33. For the purposes of section 82KZME of the ITAA 1936, ‘agreements’ are broadly defined to include an entire arrangement of which a contract may form part. Under subsection 82KZME(4) of the ITAA 1936, the relevant ‘agreement’ is all the contractual arrangements and activities associated with the participation in the Facility, including the financing, share and/or unit purchase, share and/or unit holding and disposal arrangements.

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

- the prepaid interest under the Linked Loan is incurred in respect of money borrowed to acquire shares that are listed for quotation in the official list of an approved stock exchange or units in a widely held unit trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936
- the Investor can reasonably expect to obtain dividends and/or trust income from the agreement
- the Investor will not obtain any other kind of assessable income from the agreement, except for capital gains, and
- all aspects of the agreement are conducted at arm’s length.

35. Deductibility of the prepaid interest must therefore be considered under the prepayment rules outlined in paragraphs 36 to 41 of this Product Ruling.

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

36. Section 82KZM of the ITAA 1936 operates to spread over more than one income year a deduction for prepaid expenditure incurred by a taxpayer that is either:

- a small business entity for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or
- an individual and the expenditure is not incurred in carrying on a business.

37. Section 82KZM of the ITAA 1936 applies if:

- the expenditure is not excluded expenditure
- the eligible service period for the expenditure is longer than 12 months, or the eligible service period for the expenditure is 12 months or shorter but ends after the last day of the year of income after the one in which the expenditure was incurred, and
- the expenditure would otherwise be immediately deductible under section 8-1 of the ITAA 1997.

38. As the eligible service period in relation to the deductible interest under the Linked Loan is not more than 12 months and does not end after the last day of the year of income after the one in which the expenditure was incurred, section 82KZM of the ITAA 1936 will have no application to Investors that are a small business entity that have not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or to Investors who are individuals and the expenditure is not incurred in carrying on a business. Investors that satisfy these tests will be able to claim an immediate deduction allowable under section 8-1 of the ITAA 1997 for interest incurred under the Linked Loan.

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

39. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure for an Investor (other than a small business entity for the year of income that has not chosen to apply section 82KZMD to the expenditure) that is not an individual and does not incur the expenditure in carrying on a business.

40. The expenditure must not be excluded expenditure and must be incurred in return for the doing of a thing under an agreement that is not to be wholly done within the expenditure year.

41. For these Investors, the amount of prepaid interest incurred under the Linked Loan which is allowable as a deduction under section 8-1 will be apportioned over the relevant Interest Period.

Parts 3-1 and 3-3 – application of CGT provisions to the Option and the Reference Assets

42. If an Investor's Option is exercised under a Sell Instruction, the Investor will dispose of their Reference Assets and CGT event A1 will arise for the Investor in respect of the disposal: section 104-10. Under item 2 of the table in subsection 134-1(1), the Investor's cost base and reduced cost base of the Reference Assets will include any Fixed Premium paid and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling. Any capital gain or capital loss on exercise of the Option will be disregarded: subsection 134-1(4).

43. If an Investor's Option is exercised under a Cash Settlement Request, CGT event C2 will arise for the Investor in respect of the exercise of the Option: section 104-25. The cost base and reduced cost base of the Option will include any Fixed Premium paid and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling: sections 110-25 and 110-55. No CGT event will occur in relation to the Reference Assets.

44. Where an Investor's Option is unexercised and expires, CGT event C2 will arise for the Investor in relation to the Option at that time: section 104-25. Where the Investor will not receive any capital proceeds in respect of the expiry of the Option (that is, where the circumstances contemplated by paragraph 18(s) of this Product Ruling are not applicable), a capital loss will be made by the Investor in this regard, equal to the Investor's reduced cost base in the Option. Under section 110-55, the reduced cost base of the Option will include any Fixed Premium and (where applicable) Variable Premium paid, and the additional amount (if any) calculated under paragraph 14(a)(ii) of this Product Ruling.

45. Under section 110-25 and 110-55 respectively, an Investor's cost base and reduced cost base in the Reference Assets acquired by the Investor under the Facility will include the amount of any Linked Loan used to finance the acquisition of the Reference Assets and incidental costs incurred by the Investor in acquiring and disposing of the Reference Assets (this includes stamp duty and costs of transfer). As per paragraph 42 of this Product Ruling, where the Investor's Option is exercised under a Sell Instruction, the Investor's cost base and reduced cost base in the Reference Assets also includes the cost base or reduced cost base of the Option.

46. Division 115 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5, any capital gain realised by an Investor on the sale of the Reference Assets, exercise of an Option under a Cash Settlement Request or expiry of an Option in circumstances contemplated by paragraph 18(s) of this Product Ruling will be treated as a discount capital gain where the Investor is an individual or a trust and has held the Reference Assets or Option for more than 12 months (excluding the days of acquisition and disposal).

Division 230 – taxation of financial arrangements

47. Division 230 of the ITAA 1997 sets out the tax treatment of gains or losses from a 'financial arrangement'. Where an arrangement is not a qualifying security for the purposes of Division 16E of the ITAA 1936 and an election under section 230-455 of the ITAA 1997 to have Division 230 apply to financial arrangements has not been made, then pursuant to section 230-455, Division 230 does not apply in relation to gains or losses from a financial arrangement held by:

- an individual, or
- a superannuation entity, a managed investment scheme or an entity substantially similar to a managed investment scheme under foreign law with assets of less than \$100 million, or
- an ADI, a securitisation vehicle or other financial sector entity with an aggregated turnover of less than \$20 million, or
- another entity with an aggregated turnover of less than \$100 million, financial assets of less than \$100 million and assets of less than \$300 million.

Part IVA – anti-avoidance

48. Provided that the scheme ruled on is entered into and carried out in the manner described in this Product Ruling, it is accepted that the scheme is an ordinary commercial transaction and that Part IVA of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

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TR 95/33

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