


PR 2021/13 - Tax consequences for a borrower being charged a discounted home loan interest rate calculated under Loan Reducer

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Status: **legally binding**

Product Ruling

Tax consequences for a borrower being charged a discounted home loan interest rate calculated under Loan Reducer

📌 Relying on this Ruling

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Table of Contents	Paragraph
What this Ruling is about	1
Date of effect	9
Ruling	14
Scheme	15
Appendix – Explanation	30

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) that 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.

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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 that participates in the scheme to which this Product Ruling relates. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1936*, unless otherwise indicated.
2. In this Product Ruling, the scheme involves the application of the Loan Reducer system to calculate a discounted interest rate that is charged by a licensee of the Loan Reducer system (a licensee) on the home loan of a borrower who (directly or indirectly via an associated entity) also has one or more investment loans with that licensee.
3. This Product Ruling does not address:
 - the tax consequences associated with the home loan of the borrower or with any offset account linked to the home loan and/or investment loan of the borrower
 - the deductibility of interest incurred by the borrower under their investment loan pursuant to section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997)¹
 - the tax treatment of any costs, fees and expenses payable by the borrower in respect of their home loan or investment loan
 - the tax consequences for the borrower in relation to the acquisition, holding and sale of a property or any other asset acquired with the proceeds of their investment loan, and
 - whether the scheme constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 (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 as 'the borrower'. Where the borrower under the investment loan is an associate² of the borrower under the home loan, all references to the borrower under this Product Ruling are to be read as a reference to the applicable borrower under either loan, as the context requires.
5. The class of entities that can rely on the Ruling section of this Product Ruling consists of those entities that, as the borrower, enter into the scheme described in paragraphs 15 to 29 of this Product Ruling on or after 17 November 2021 and on or before 30 June 2024.
6. The class of entities that can rely on the Ruling section of this Product Ruling does **not** include entities that:
 - are non-residents for Australian tax purposes, or
 - as the borrower, enter into the scheme described in paragraphs 15 to 29 of this Product Ruling before 17 November 2021 or after 30 June 2024.

¹ For the purposes of this Product Ruling, it is assumed at paragraph 29(b) of this Product Ruling that interest incurred by the borrower under their investment loan is deductible under section 8-1 of the ITAA 1997.

² Where used in this Product Ruling, the word 'associate' has the meaning given in section 318.

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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 29 of 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
- may be withdrawn or modified.

Date of effect

9. This Product Ruling applies prospectively from 17 November 2021. It therefore applies only to the specified class of entities that enter into the scheme from 17 November 2021 until 30 June 2024, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application has ended for schemes 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 that are considering participating in the scheme are advised to confirm with their tax 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. The application of Part IVA depends on a careful weighing of all the relevant facts and circumstances of each case. Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA will not apply to deny the borrower any deduction allowable under section 8-1 of the ITAA 1997 for interest incurred on their investment loan.

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Scheme

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

- application for a Product Ruling as constituted by documents and information received on 6 January 2015, 17 February 2015, 18 February 2015, 16 May 2017, 30 May 2017, 31 July 2020, 11 September 2020 and 17 December 2020, and
- draft Loan Reducer Licence Agreement received on 17 December 2020.

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, and aside from the relevant home and investment loan documentation to be executed between the borrower and the licensee, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which the borrower, or any associate of the borrower, will be a party to, which are a part of the scheme.

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

Overview

18. Loan Reducer Pty. Ltd., under the terms of the Loan Reducer Licence Agreement, grants to licensees (being lenders or entities operating on behalf of, and performing functions for, lenders) a licence to access and use the Loan Reducer system in accordance with the system procedures issued from time to time by Loan Reducer Pty. Ltd.

19. The Loan Reducer system is a system which enables lenders to determine the maximum tolerable reduction (if any) to a borrower's home loan interest rate in recognition of the borrower's broader loan portfolio. The system achieves this via the application of a financial model which enables a lender to calculate on an ongoing basis a level of discount that can be applied to a borrower's home loan interest rate as against the standard variable home loan rate of the lender, and bring the lender's total return on all money loaned to the borrower close to a rate (a 'target rate') which produces an acceptable baseline profit for the lender.

20. The Loan Reducer system is offered by a licensee at its discretion to borrowers with a home loan in respect of a residential property that is their main residence, and (directly or indirectly via a company or trust that is an associate of the borrower) an investment loan used to fund an asset acquired for the purposes of producing assessable income. The asset acquired with the investment loan may be a residential property other than the borrower's main residence, or any other asset other than for business use.

21. The Loan Reducer system automatically applies a recalculated interest rate to a borrower's home loan where:

- the lender varies its target rate
- the lender's standard variable rate for either home loan or investment loan changes

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- either of the borrower's home loan or investment loan is substantially repaid, and/or
- a new/refinanced loan is advanced.

22. Subject to the occurrence of any of the factors listed in paragraph 21 of this Product Ruling, a discounted interest rate on a borrower's home loan, as calculated under the Loan Reducer system, is applied for two years, following which the borrower's loan portfolio with the licensee is reviewed and may result in a further home loan interest rate adjustment.

23. Except for the discounted interest rate (which is subject to a floor rate of 0.50% above the Reserve Bank of Australia (RBA) cash rate), home loans subject to the Loan Reducer system are offered, struck and maintained on standard terms in all respects.

24. The borrower's investment loan is not affected by the Loan Reducer system and is, or remains, on standard terms in all respects (subject to a ceiling on the rate of interest charged above the RBA cash rate³). The ceiling on the rate of interest is:

- set at 4.57% above the RBA cash rate as at 17 November 2021, and
- reviewed on a monthly basis against the market.

25. The Loan Reducer system does not apply a recalculated interest rate to a borrower's investment loan. **A borrower cannot rely on the Ruling section of this Product Ruling if the interest rate charged on the borrower's investment loan increases as a result of, or in connection with, a discount of the interest rate applied to the borrower's home loan.**

26. The Loan Reducer system does not allow for the interest rate charged on a new/refinanced investment loan to a borrower to be either a leading rate⁴ or higher than the lender's standard variable rate for that particular type of investment loan⁵ (even where the lender's standard variable rate for that type of investment loan is lower than the ceiling referred to in paragraph 24 of this Product Ruling). **A borrower cannot rely on the Ruling section of this Product Ruling if the restrictions set out in this paragraph are not adhered to.**

27. Neither of the borrower's home loan or investment loan:

- is or will be part of a linked or split loan facility as described in paragraphs 3 to 6 of Taxation Ruling TR 98/22 *Income tax: the taxation consequences for taxpayers entering into certain linked or split loan facilities*
- involves or will involve any capitalisation of interest
- is or will be subject to any cross collateralisation (outside of any standard bank security arrangements), or
- is or will be part of an 'investment loan interest payment arrangement' as described in Taxation Determination TD 2012/1 *Income tax: can Part IVA of the Income Tax Assessment Act 1936 apply to deny a deduction for some,*

³ Notwithstanding this ceiling, the interest rate charged on the investment loan cannot exceed the lender's standard variable rate for that particular type of investment loan (for example, the lender's standard variable rate for interest-only investment loans).

⁴ For the purposes of this Product Ruling, a 'leading rate' refers to an investment loan interest rate that is higher than the average standard variable rate for an equivalent investment loan offered by the 'Big Four' banks at the time.

⁵ For example, if the borrower's new/refinanced investment loan is an interest-only loan, the interest rate charged to the borrower cannot be higher than the lender's standard variable interest rate for interest-only investment loans.

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or all, of the interest expense incurred in respect of an 'investment loan interest payment arrangement' of the type described in this Determination?

28. The licensees are:

- Crown Lending Pty. Ltd.
- Client Solution Centre Pty Ltd (trading as CSC Home Loans)
- Loan Avenue Holdings Pty Ltd
- Oak Lending Pty Ltd
- AxisWealth Group Pty Ltd (trading as Axis Lending)
- Pinpoint Publishing Pty Limited & Speed Media Australia Pty. Limited (trading as Vision Property and Finance)
- Dreamstreet Lending Pty Ltd
- One26 Financial Services Group Pty Ltd, and
- Better Choice Home Loans Pty. Limited.

Assumptions

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

- (a) The borrower is an Australian resident for tax purposes.
- (b) The investment loan is used to acquire or refinance an asset held by the borrower for the purposes of gaining or producing assessable income and the interest incurred by the borrower under that loan is deductible from their assessable income pursuant to section 8-1 of the ITAA 1997.
- (c) The borrower does not draw down on a line of credit to pay the interest on the investment loan.
- (d) All dealings between the borrower and the licensee are at arm's length.
- (e) The scheme is executed in the manner described in the Scheme section of this Product Ruling.

Commissioner of Taxation

17 November 2021

 Status: **not legally binding**

Appendix – 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.*

Table of Contents	Paragraph
Refinancing an original loan	30
Application of Part IVA	32

Refinancing an original loan

30. The interest expense on a new loan will be deductible if the new loan is used to repay an existing loan which, at the time of the second borrowing, was being used in an assessable income-producing activity (see paragraph 42 of Taxation Ruling TR 95/25 *Income tax: deductions for interest under section 8-1 of the Income Tax Assessment Act 1997 following FC of T v. Roberts; FC of T v. Smith*, referring to *Commissioner of Taxation v Roberts, J.D. Commissioner of Taxation v Smith, V.R. [1992] FCA 543*).

31. Pursuant to the assumption at paragraph 29(b) of this Product Ruling, the borrower’s investment loan is used in an assessable income-producing activity. On the basis of that assumption and consistent with the principle set out in paragraph 30 of this Product Ruling, interest incurred on any refinanced investment loan of the borrower will therefore also be deductible under section 8-1 of the ITAA 1997.

Application of Part IVA

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

33. In broad terms, Part IVA will apply where the following requirements are satisfied:

- there is a ‘scheme’ as defined in section 177A
- there is a ‘tax benefit’ that, in relation to allowable deductions, is defined in paragraph 177C(1)(b) as a deduction being allowable to the taxpayer in relation to a year of income where the whole or part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out
- having regard to the eight objective matters identified in subsection 177D(2), it would be concluded by a reasonable person that the person, or one of the persons, who entered into or carried out the scheme (or any part of it) did so for the dominant purpose of enabling the taxpayer to obtain the tax benefit in connection with the scheme, and
- the Commissioner makes a determination that the whole or part of the amount of the tax benefit that is referable to the deduction shall not be allowable (paragraph 177F(1)(b)).

PR 2021/13

Status: **not legally binding**

34. Provided that the scheme ruled on is entered into and carried out in the manner described in the Scheme section of this Product Ruling, and having regard to the matters in subsection 177D(2), it is not a scheme entered into or carried out for the dominant purpose of enabling the borrower to obtain a tax benefit in connection with the scheme.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/25; TR 98/22; TD 2012/1

Legislative references:

- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C(1)(b)
- ITAA 1936 177D(2)
- ITAA 1936 177F

- ITAA 1936 177F(1)(b)
- ITAA 1936 318
- ITAA 1997 8-1
- ITAA 1997 Div 230
- TAA 1953

Case references:

- Commissioner of Taxation v Roberts J.D.
Commissioner of Taxation v Smith, V.R.
[1992] FCA 543; 37 FCR 246; 92 ATC
4380; 23 ATR 494; 108 ALR 385

ATO references

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