



# ***PR 2022/2 - Tax consequences of investing in C2 Gateway Deferred Purchase Agreement***

 This cover sheet is provided for information only. It does not form part of *PR 2022/2 - Tax consequences of investing in C2 Gateway Deferred Purchase Agreement*

 This document has changed over time. This is a consolidated version of the ruling which was published on *12 July 2023*



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Status: **legally binding**

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## Product Ruling

# Tax consequences of investing in C2 Gateway Deferred Purchase Agreement

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### **📌 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.

[**Note:** *This is a consolidated version of this document. Refer to the Legal database ([ato.gov.au/law](https://ato.gov.au/law)) to check its currency and to view the details of all changes.*]

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## **No guarantee of commercial success**

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

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

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

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## **Terms of use of this Product Ruling**

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This Product Ruling has been given on the basis that the entity 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.

### **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 takes part in the scheme to which this Product Ruling relates. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.
2. In this Product Ruling the scheme is referred to as C2 Gateway Deferred Purchase Agreement (DPA), offered by C2 Specialist Investments Pty Ltd (the Issuer).<sup>1</sup>
3. This Product Ruling does not address:
  - the tax consequences of paying any fee (including any Adviser Fee) other than the Loan Establishment Fee
  - the tax consequences of an assignment and novation of an Investor's rights and obligations under the Terms
  - the tax consequences of an
    - Investor Insolvency
    - exercise of the Annual Walk Away Option
    - Early Maturity Event
    - Issuer Buy-Back, or
    - Adjustment Event.
  - the tax consequences upon enforcement of the Security Trust Deed by the Security Trustee on behalf of the Investors
  - the tax consequences upon enforcement of the Hedge Security Deed by the Security Trustee on behalf of the Investors
  - the tax consequences of taking delivery of, holding and disposing of the Delivery Parcel
  - the tax consequences associated with the holding of a Beneficial Interest in a Portion of the Delivery Assets
  - the tax consequences that may arise where a Coupon is not paid in Australian dollars
  - whether the scheme constitutes a deferred purchase agreement, and
  - whether the scheme constitutes a financial arrangement for the purposes of Division 230 (taxation of financial arrangements).

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<sup>1</sup> Unless otherwise defined, capitalised terms in this Product Ruling take their meaning from the C2 Gateway Deferred Purchase Agreement Master Product Disclosure Statement (Master PDS) referred to in paragraph 16 of this Product Ruling.

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### **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 Investors.

5. The class of entities that can rely on the Ruling section of this Product Ruling consists of those entities whose rights and obligations under the Terms will commence on a relevant Issue Date, being an Issue Date on or between 1 July 2022 and 30 June 2025, and that 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 Terms until their term expires), and
- have a realistic expectation of deriving assessable income from the scheme that exceeds the deductible expenditure that they incur in respect of it.<sup>2</sup>

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
- whose rights and obligations under the Terms commence other than on a relevant Issue Date (see paragraph 5 of this Product Ruling)
- that, 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
- that, at the time of entering into the scheme and on each interest payment date thereafter, do not intend to derive assessable income from the scheme that exceeds the deductible expenditure that they incur in respect of it
- that participate in the scheme through offers made other than through the Master PDS and a C2 Gateway Term Sheet Product Disclosure Statement (Term Sheet PDS); or that 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
- that trade in financial instruments or securities and are treated for tax purposes as trading in the Units and/or the Delivery Assets, carrying on a business of investing in the Units and/or the Delivery Assets, or holding the Units and/or the Delivery Assets as trading stock or as revenue assets, or
- that are subject to Division 230 in respect of this scheme.

### ***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

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<sup>2</sup> Income arising from any Delivery Assets delivered to the Investor at Maturity does not constitute 'assessable income from the scheme'.

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Ruling as to whether investment in this scheme may contravene the provisions of the SISA.

### **Qualifications**

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 20 of this Product Ruling.

9. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then this Product Ruling:

- has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- may be withdrawn or modified.

### **Date of effect**

10. This Product Ruling applies from 1 July 2022. It applies only to the specified class of entities that enter into the scheme on a relevant Issue Date (see paragraph 5 of this Product Ruling). This Product Ruling provides advice to the specified class of entities from 1 July 2022 until 30 June 2025, being its period of application. Where relevant, this Product Ruling will continue to apply to those entities even after its period of application has ended for the scheme entered into on a relevant Issue Date.

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 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**

14. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention, the Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

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## **Ruling**

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

- (a) Any Coupons received under the C2 Gateway DPA will be included in the net income of an Investor Trust constituted under the Custody Deed Poll, under which the Units are held on separate trust for the Investor by the Custodian. The Investor is assessable under section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936) on a share of the net income of that trust estate that reflects the proportion of income of the trust estate to which the Investor is presently entitled. The present entitlement of the Investor will reflect the Investor's rights to Coupons derived in respect of the Units in which the Investor has an interest.
- (b) Interest incurred by the Investor in respect of their Investment Loan under the C2 Gateway DPA is deductible under section 8-1. This deduction is allowable in the income year incurred, subject to the application of the provisions discussed at paragraphs 15(f), (g) and (h) of this Product Ruling.
- (c) Interest incurred by the Investor in respect of their Interest Loan (if any) under the C2 Gateway DPA is deductible under section 8-1 in the income year incurred.
- (d) Section 51AAA of the ITAA 1936 will not apply to deny the Investor a deduction for the interest incurred under the Investment Loan or the Interest Loan (if applicable) that is allowable as a deduction under section 8-1.
- (e) Section 82KL of the ITAA 1936 will not apply to deny the amount of interest under the Investment Loan or the Interest Loan (if any) that is allowable as a deduction under section 8-1.
- (f) Sections 82KZME and 82KZMF of the ITAA 1936 will apply to set the amount and timing of deductions for each Prepaid Interest amount which
  - (i) is allowable as a deduction under 8-1
  - (ii) is not less than \$1,000
  - (iii) relates to a period extending beyond the end of the income year in which the Prepaid Interest is incurred, and
  - (iv) is incurred by an Investor whose allowable deductions that are attributable to the C2 Gateway DPA for the income year in which the Prepaid Interest is incurred exceeds the Investor's assessable income that is attributable to the C2 Gateway DPA for that same year.
- (g) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for each Prepaid Interest amount which
  - (i) is allowable as a deduction under section 8-1
  - (ii) is not less than \$1,000
  - (iii) relates to a period extending beyond the end of the income year in which the Prepaid Interest is incurred, and
  - (iv) is incurred by an Investor (other than a small business entity, or an entity covered by subsection 82KZMA(2A) of the ITAA 1936, for the

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- year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure) that is not an individual and does not carry on a business.
- (h) Section 82KZM of the ITAA 1936 will apply to set the amount and timing of deductions for each Prepaid Interest amount which
    - (i) is allowable as a deduction under section 8-1
    - (ii) is not less than \$1,000
    - (iii) relates to either a period that is longer than 12 months or a period that is 12 months or shorter but ends after the last day of the year of income after the one in which the Prepaid Interest was incurred, and
    - (iv) is incurred by an Investor that is either a small business entity, or an entity covered by subsection 82KZM(1A) of the ITAA 1936, that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or an individual who doesn't incur the expenditure in carrying on a business.
  - (i) The Investor's legally enforceable rights under the Terms are, in their totality, a CGT asset under subsection 108-5(1).
  - (j) The Investor's ownership of those contractual rights in respect of the C2 Gateway DPA comes to an end by reasons of those rights being discharged or satisfied upon either
    - (i) payment of any Final Coupon calculated at Maturity, and sale of the Delivery Parcel and application or payment of the Sale Monies using the Agency Sale Option, or
    - (ii) payment of any Final Coupon calculated at Maturity and delivery of the Delivery Parcel to the Investor.
  - (k) A CGT event C2 happens under section 104-25 at this time.
  - (l) The Investor's capital proceeds under section 116-20 from the CGT event will, as applicable, be equal to the Sale Monies obtained under the Agency Sale Option, or the market value of the Delivery Parcel received by the Investor on (or shortly after) the Settlement Date.
  - (m) The cost base or reduced cost base of the Investor's contractual rights under the C2 Gateway DPA includes the Investment Amount (subsections 110-25(2) and 110-55(2)).
  - (n) The commercial debt forgiveness rules in Division 245 will not apply to reduce the tax attributes of an Investor as a result of the debt forgiveness that occurs when the limited recourse provisions of the Investment Loan come into effect if at Maturity insufficient Sale Monies are raised from the Agency Sale Option in order for the Investor to fully repay the loan.
  - (o) The Units under the C2 Gateway DPA are not 'securities', as defined in subsection 159GP(1) of the ITAA 1936.
  - (p) Any Loan Establishment Fee incurred by the Investor is deductible under section 25-25.
  - (q) Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA of the

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ITAA 1936 will not apply to the Investor in respect of an investment in Units offered under the C2 Gateway DPA.

## Scheme

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16. 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 4 February 2022 and 20 June 2023
- C2 Gateway Deferred Purchase Agreement Master Product Disclosure Statement dated 25 March 2020
- draft C2 Gateway Deferred Purchase Agreement Supplementary Product Disclosure Statement, received on 4 February 2022
- draft C2 Gateway Deferred Purchase Agreement Supplementary Product Disclosure Statement, received on 20 June 2023
- draft C2 Gateway Term Sheet Product Disclosure Statements, received on 4 February 2022
- Hedge Security Deed between the Issuer (as Grantor) and the Custodian (as the Secured Party) dated 20 March 2018
- Custody Deed Poll between the Issuer (as the Secured Party) and the Custodian dated 6 March 2020 and First Supplemental Deed Poll (Custody Deed Poll) dated 11 March 2020
- Global Investor Security Deed between the Issuer (as the Secured Party) and the Custodian (as the Grantor) dated 6 March 2020 and First Supplemental Deed Poll (Global Investor Security Deed) dated 11 March 2020, and
- Security Trust Deed between the Issuer and the Custodian (as the Security Trustee) dated 20 March 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.

17. 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.

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

### Overview

19. The details of the C2 Gateway DPA are summarised as follows:

- (a) An offer to participate in the C2 Gateway DPA will be made to prospective investors in various Series by way of the Master PDS (supplemented by the C2 Gateway Deferred Purchase Agreement Supplementary Product Disclosure Statement) and a Term Sheet PDS. Each Series will be

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- governed by the general terms in the Master PDS and specific terms in the Term Sheet PDS which are applicable to that Series (the Terms).
- (b) On acceptance of an Investor's Application and receipt by the Issuer of the amounts payable by the Investor by the Offer Closing Date, the Issuer will issue Units on the Issue Date to the Custodian to hold in separate Investor Trusts for the Investor on the terms of the Custody Deed Poll and subject to the terms of the Investor Security Deed. Upon the issue of those Units, the Investor will receive a beneficial interest in a Portion of the Delivery Assets (Beneficial Interest). That Beneficial Interest may not be dealt with separately in any way from the Investor's interest in the Units.
  - (c) The Minimum Investment Amount required to be invested by each Investor will be set out in the relevant Term Sheet PDS for a Series. The Issue Price of a Unit will be \$1.00 per Unit.
  - (d) One or more Coupons may be payable in respect of issued Units, as specified in the relevant Term Sheet PDS, and the Custodian directs the Issuer to pay those Coupons on the relevant Coupon Payment Dates directly to the Investor (as the beneficiary of each relevant Investor Trust). The Coupons comprise of
    - (i) one or more Fixed Coupons (if any), calculated as a percentage of the Issue Price per Unit, and
    - (ii) one or more Performance Coupons (including any Final Coupon) conditional upon the positive performance of the Reference Asset for the previous year or, in the case of a Final Coupon, the positive performance of the Reference Asset over the Investment Term, and potentially subject to averaging, Hurdles or Performance Caps, a Participation Rate, foreign currency risk, the amount of any previous Coupon or any other variable as specified in the relevant Term Sheet PDS.
  - (e) Investors must enter into a limited recourse Investment Loan from the Issuer, as Lender, to finance up to 100% of the Investment Amount payable to the Issuer.
  - (f) The Investment Loan
    - (i) bears interest (the Prepaid Interest) at a rate fixed for the Investment Term, payable on the Prepaid Interest Payment Dates (the first of which will be on the Issue Date) and generally payable in advance for a period which may or may not exceed 12 months
    - (ii) is repayable on or before the Maturity Date, unless either Early Maturity or an Investor Insolvency occurs and subject to application of the limited recourse feature whereby the Lender's recourse against the Investor for repayment is limited to the Investor's interest in the Units and any assets of each Investor Trust referable to the Investor
    - (iii) is subject to a Security Interest granted under the Investor Security Deed by the Custodian to the Lender in all of the Custodian's rights to property of each Investor Trust referable to the Investor and held by it in respect of the Investor to secure payment of the Investor's obligations under the Loan Agreement, and

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- (iv) may have a Loan Establishment Fee of up to 2.2% of the Investment Loan, payable by the Issue Date.
- (g) Investors that are not superannuation entities may be offered a full recourse Interest Loan from the Issuer, as Lender, to fund up to 100% of the Prepaid Interest owing to the Lender under the Investment Loan. The Interest Loan
  - (i) bears interest at a fixed rate
  - (ii) is repayable on or before the Interest Loan Maturity Date, unless either Early Maturity or an Investor Insolvency occurs, and
  - (iii) is subject to the Security Interest referred to in paragraph 19(f)(iii) of this Product Ruling.
- (h) Where the Investor repays the Investment Loan and any Interest Loan in full on or before the Maturity Date and does not validly elect to use the Agency Sale Option under a Notice of Maturity at least 10 Business Days before the Maturity Date, physical delivery of the Delivery Parcel will occur. Where this occurs, the Issuer will purchase the Delivery Parcel, register the shares in an issuer sponsored holding account in the name of the Investor, and deliver the Delivery Parcel to the Investor on the Settlement Date or as soon as possible thereafter.
- (i) Where the Investor validly elects to use the Agency Sale Option under a Notice of Maturity at least 10 Business Days before the Maturity Date, or does not repay their Investment Loan and any Interest Loan in full by the Maturity Date and is deemed to have elected to use the Agency Sale Option, the Investor assigns and novates their rights and obligations under the Loan Agreement to the Arranger and the Issuer will be directed by the Custodian to sell the Delivery Parcel on or as soon as reasonably practicable after the Settlement Date. The Sale Monies will be applied to repay the Loan Amount (where not repaid) or paid to the Investor (where the Loan Amount is repaid by the Maturity Date).
- (j) Upon delivery of the Delivery Parcel as outlined in paragraph 19(h) of this Product Ruling or the payment of application of the Sale Monies in accordance with paragraph 19(i) of this Product Ruling, the Issuer's obligations to the Investor under the Terms will be satisfied and discharged.
- (k) The features of each Series described in a Term Sheet PDS will include
  - (i) the Reference Asset
  - (ii) the Investment Term, ranging between 3 months and 10 years
  - (iii) the interest rate applicable to the Investment Loan and Interest Loan (if any)
  - (iv) the Interest Payment Dates
  - (v) the Interest Loan Maturity Date
  - (vi) applicable Fees, including any Loan Establishment Fee
  - (vii) calculation of the Final Coupon and any other Performance Coupons
  - (viii) any Fixed Coupons (as a percentage of the Issue Price per Unit)
  - (ix) the Coupon Payment Dates
  - (x) key risks to Investors

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- (xi) the Delivery Asset (being a share in a company listed on the Australian Securities Exchange)
  - (xii) the Final Value of a Unit on the Maturity Date, and
  - (xiii) the Minimum Investment Amount.
- (l) The Reference Asset to which the Units will provide exposure over the Investment Term will be any one or more of the following
- (i) the S&P/ASX 200 Index, the S&P 500 Index, the Euro Stoxx 50 Index or any other equities index
  - (ii) any exchange traded security or fund
  - (iii) any hedge fund
  - (iv) any unlisted managed investment scheme
  - (v) any proprietary index
  - (vi) any commodity, or
  - (vii) a basket comprised of two or more of the Reference Assets listed in this subparagraph.

### **Assumptions**

20. This Product Ruling is made on the basis of the following necessary assumptions:
- (a) The Investor is an Australian resident for tax purposes.
  - (b) The Investor is not a trader in financial instruments or securities and is not treated for tax purposes as trading in the Units and/or the Delivery Assets, carrying on a business of investing in the Units and/or the Delivery Assets, or holding the Units and/or the Delivery Assets as trading stock or as revenue assets.
  - (c) The Investor has not made an election under section 230-455 to have Division 230 apply to their financial arrangements and is
    - (i) an individual
    - (ii) 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
    - (iii) an ADI, a securitisation vehicle or other financial sector entity with an aggregated turnover of less than \$20 million, or
    - (iv) 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.
  - (d) The dominant purpose of the Investor in entering into the scheme is to derive assessable income from the scheme that exceeds the deductible expenditure that they incur in respect of it.
  - (e) The Investor will, at the time of entering into the scheme, have a purpose of staying in the scheme until it is completed, and will not terminate their involvement in the scheme prior to the Maturity Date.

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- (f) An Investor that is a complying superannuation fund is not prevented from investing in the scheme by any particular terms of its trust deed, and is not in breach of any stated investment strategy.
- (g) The Final Value of the Units on the Maturity Date will be \$1.00 per Unit.
- (h) The scheme will be executed in the manner described in the Scheme section of this Product Ruling and the scheme documentation mentioned in paragraph 16 of this Product Ruling.
- (i) All dealings between the Investor, the Issuer, the Arranger and the Custodian will be at arm's length.

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**Commissioner of Taxation**  
23 March 2022

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## Appendix – Explanation

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**!** *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.*

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### **Assessability of trust income**

21. Any Fixed Coupon and Performance Coupon paid by the Issuer on the Units held by the Custodian on trust for the Investor are ordinary income of the trust constituted under the Custody Deed Poll and included in the calculation of the trust estate’s net income pursuant to section 95 of the ITAA 1936 in the income year in which they are paid.

22. The Investor shall be assessable under section 97 of the ITAA 1936 on a share of the net income of the trust that reflects the proportion of income of the trust estate to which the Investor is presently entitled.

### **Deductibility of interest under section 8-1**

23. A loss or outgoing is deductible under section 8-1 if its essential character is that of expenditure that has a sufficient connection with the operations or activities which more directly gain or produce a taxpayer’s assessable income, provided that the expenditure is not of a capital, private or domestic nature.

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24. Interest incurred by the Investor on the Investment Loan and the Interest Loan (if applicable) under the C2 Gateway DPA has a sufficient connection with the gaining of assessable income (being trust income) to be deductible under section 8-1 and is deductible in full on the basis that the Investor's purpose of investing in the Units is to derive a return from these assessable amounts in excess of their expenditure.

#### **Section 82KL of the ITAA 1936**

25. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefits' (as defined in section 82KH of the ITAA 1936). Insufficient additional benefits will be provided to trigger the application of section 82KL of the ITAA 1936. Section 82KL of the ITAA 1936 will not apply to deny the deductions otherwise allowable under section 8-1.

#### **Subdivision H of Division 3 of Part III of the ITAA 1936**

26. Subdivision H of Division 3 of Part III (Subdivision H) of the ITAA 1936 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 the carrying on of 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 of expenditure that are of a capital nature.

#### ***Subdivision 328-C – small business entities for the purposes of Subdivision H of the ITAA 1936***

27. 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 of the ITAA 1936***

28. The Prepaid Interest charged on the Investment Loan that is deductible under section 8-1 may or may not be 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

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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 of the ITAA 1936 – prepaid expenditure and ‘tax shelter’ style arrangements***

29. The rules in sections 82KZME and 82KZMF of the ITAA 1936 apply, subject to the exceptions in section 82KZME of the ITAA 1936, where expenditure is incurred in relation to a ‘tax shelter’ style arrangement for the doing of a thing under an agreement that is not to be wholly done within the expenditure year, and where certain requirements for that agreement are met.

30. For the purposes of section 82KZME of the ITAA 1936, ‘agreements’ are broadly defined to include an entire scheme 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 participation in the C2 Gateway DPA, including the financing.

31. Section 82KZMF of the ITAA 1936 will have operation and apportion over the relevant period each Prepaid Interest amount incurred by the Investor which is allowable as a deduction under section 8-1 where:

- the Prepaid Interest is not excluded expenditure and is for a period extending beyond the end of the income year in which it is incurred, and
- the Investor’s allowable deductions that are attributable to the C2 Gateway DPA for the income year in which the Prepaid Interest is incurred exceeds their assessable income that is attributable to the C2 Gateway DPA for that same year.

32. Each of the other requirements for the agreement under subsection 82KZME(3) of the ITAA 1936 are met and none of the other exceptions contained in subsections 82KZME(5), (8) or (9) of the ITAA 1936 apply to exclude Prepaid Interest incurred from the operation of section 82KZMF of the ITAA 1936.

***Sections 82KZMA and 82KZMD of the ITAA 1936 – prepaid non-business expenditure incurred by non-individual and non-small business entities***

33. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure that an Investor (other than a small business entity, or an entity covered by subsection 82KZMA(2A) of the ITAA 1936<sup>3</sup>, for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure) that is not an individual and does not incur the expenditure in carrying on a business. 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.

34. For these Investors, the amount of Prepaid Interest incurred under the Investment Loan which is allowable as a deduction under section 8-1 will be apportioned over the relevant interest payment period.

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<sup>3</sup> An entity is covered by subsection 82KZMA(2A) of the ITAA 1936 for the expenditure year if the entity is not a small business entity for that year but would be a small business entity for that year if each reference to \$10 million in section 328-110 (as noted in paragraph 27 of this Product Ruling) were instead a reference to \$50 million).

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Status: **not legally binding**

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**Section 82KZM of the ITAA 1936 – prepaid expenditure incurred by certain small business entities and individuals incurring non-business expenditure**

35. Subject to paragraph 36 of this Product Ruling, section 82KZM of the ITAA 1936 operates to spread over more than one income year a deduction which, apart from that section, would be allowable under section 8-1 for the year of income in which the prepaid expenditure is incurred under an agreement by a taxpayer that is either:

- a small business entity, or an entity covered by subsection 82KZM(1A) of the ITAA 1936<sup>4</sup>, for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or
- an individual that has not incurred the expenditure in carrying on a business.

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

- the prepaid expenditure is not excluded expenditure, and
- 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.

37. Where the Prepaid Interest is not excluded expenditure and the eligible service period in relation to the deductible Prepaid Interest under the Investment Loan is more than 12 months, section 82KZM of the ITAA 1936 will have application to Investors that are a small business entity (or an entity covered by subsection 82KZM(1A) of the ITAA 1936) for the year of income and that have not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or to Investors who are individuals that have not incurred the expenditure in carrying on a business.

**Application of the capital gains tax provisions to Units under the C2 Gateway Deferred Purchase Agreement**

38. Under subsection 108-5(1) a CGT asset is any kind of property or a legal or equitable right that is not property. The rights of an Investor under the Terms to the C2 Gateway DPA are legally enforceable rights and therefore, in their totality, a CGT asset according to the definition in subsection 108-5(1).

39. Where the Final Coupon calculated at Maturity (if any) is paid to the Investor, together with either delivery of the Delivery Parcel or application or payment of the Sale Monies under the Agency Sale Option, the Investor's ownership of the contractual rights under the C2 Gateway DPA is discharged or satisfied. This discharge or satisfaction of the contractual rights gives rise to CGT event C2 (paragraph 104-25(1)(b)).

40. The Investor will make a capital gain from this CGT event if the capital proceeds from the ending of the Investor's ownership of the asset are more than the asset's cost base or, alternatively, a capital loss from this CGT event if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3)).

41. The Investor's capital proceeds from the CGT event will be equal to the Sale Monies applied against the Investment Loan on behalf of the Investor and/or received by

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<sup>4</sup> An entity is covered by subsection 82KZM(1A) of the ITAA 1936 for the expenditure year if the entity is not a small business entity for that year but would be a small business entity for that year if each reference in section 328-110 to \$10 million (as noted in paragraph 27 of this Product Ruling) were instead a reference to \$50 million).

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Status: **not legally binding**

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the Investor under the Agency Sale Option, or the market value of the Delivery Parcel received on (or shortly after) the Settlement Date, as applicable (section 116-20).

42. The cost base or reduced cost base of the Investor's rights under the C2 Gateway DPA includes, as its first element, the Investment Amount (subsections 110-25(2) and 110-55(2)).

#### **Division 245 – commercial debt forgiveness**

43. The Investment Loan will be treated as a 'commercial debt' under section 245-10.

44. Where the limited recourse provisions of the Investment Loan come into effect, an Investor is not required to repay the shortfall between the Loan Amount and the redemption proceeds of the Units. This will result in the forgiveness of a commercial debt at that time, under paragraph 245-35(a).

45. Under Division 245, where the forgiveness of a commercial debt results in the Investor having a positive 'net forgiven amount', the Investor will be required to reduce certain tax attributes that could otherwise reduce their taxable income (in the same or a later income year), to the extent of the net forgiven amount.

46. To calculate the net forgiven amount of a debt, it is first necessary to calculate the 'gross forgiven amount' of a debt. In the Investor's circumstances, Division 245 will have no practical effect as there will be no gross forgiven amount in respect of the Investment Loan. The gross forgiven amount is equal to the value of the debt when it is forgiven (worked out under section 245-60) less the amount (if any) that is offset against the value of the debt when it is forgiven (worked out under section 245-65).

47. As the value of the Investment Loan when it is forgiven will be equal to the amount that is offset against the value of that loan when it is forgiven, there will be no gross forgiven amount in respect of the Investment Loan (subsection 245-75(2)).

48. Accordingly, the commercial debt forgiveness rules in Division 245 will not reduce the tax attributes of an Investor as a result of the debt forgiveness that occurs when the limited recourse provisions of the Investment Loan come into effect.

#### **Subsection 159GP(1) of the ITAA 1936 – a Unit is not a 'security'**

49. Under subsection 159GP(1) of the ITAA 1936, a 'security' means:

- (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
- (b) a deposit with a bank or other financial institution;
- (c) a secured or unsecured loan; or
- (d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

50. The Units issued under the C2 Gateway DPA are not considered to have sufficient debt like obligations to be a contract to which paragraph (d) of the definition of security in subsection 159GP(1) of the ITAA 1936 applies, nor do they fall within paragraphs (a), (b) or (c) of that definition. Therefore, such Units do not meet the definition of security under subsection 159GP(1) of the ITAA 1936.

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Status: **not legally binding**

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**Section 25-25 – Loan Establishment Fee**

51. The Loan Establishment Fee, if applicable, incurred by an Investor upon successful application for an Investment Loan will be an allowable deduction pursuant to section 25-25 because it is a cost of borrowing money which is used for the purpose of producing assessable income. The Loan Establishment Fee will be deductible on a straight line basis over the period of the shorter of:

- the term of the Investment Loan, or
- five years.

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Status: **not legally binding**

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Not previously issued as a draft

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