

# ***PR 2022/8 - Bell Geared Equities Investment***



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## Product Ruling

# Bell Geared Equities Investment

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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.

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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.

## Terms of use of this Product Ruling

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This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

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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 1997*, unless otherwise indicated.
2. In this Product Ruling the scheme is referred to as Bell Geared Equities Investment (GEI loan), which is a loan offered by Bell Potter Capital Limited (BPC) to acquire GEI Securities under the Bell Geared Equities Investment Product Brochure dated 11 November 2019 (Product Brochure).<sup>1</sup> In this Product Ruling, a reference to GEI Securities includes a reference to a portfolio of GEI Securities.
3. This Product Ruling does not address the tax consequences of rolling the GEI Securities into a new GEI loan for another term, or the Limited Trading feature. Interest deductions under section 8-1 for the amount referred to in paragraph 15(d) of this Product Ruling are available to the investor up to the time that the investor uses one or both of these features.
4. This Product Ruling does not address:
  - an investor's entitlement to franking credits
  - the assessability of any Distributions received, or entitled to be received, by an investor in respect of their GEI Securities
  - the tax consequences of paying any fees and expenses other than interest and the Loan Establishment Fee
  - the tax consequences of a refund of prepaid interest in accordance with clause 4.6 of the Loan and Security Agreement
  - the tax consequences of any expenditure incurred as a result of extending the Final Maturity Date in accordance with the definition in clause 27.17 of the Loan and Security Agreement
  - the tax consequences of acquiring a GEI loan in respect of GEI Securities that an investor already holds and offers as security for the loan, for other investment purposes
  - whether the GEI loan constitutes a financial arrangement for the purposes of Division 230 (taxation of financial arrangements)
  - the tax consequences of an early termination of the GEI loan upon the occurrence of an Event of Default or at the investor's request, or
  - the tax consequences of any transactions entered into or payments made as a result of a corporate action, or otherwise involving the transfer of GEI Securities to and from the Nominee.

### **Class of entities**

5. 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.

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<sup>1</sup> Unless otherwise defined, capitalised terms in this Product Ruling take their meaning from the Product Brochure referred to in paragraph 16 of this Product Ruling.

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

- are accepted to participate in the scheme described in paragraphs 16 to 20 of this Product Ruling on or after 1 July 2022 and on or before 30 June 2025, and
- at the time of entering into the scheme, and on each Interest Payment Date thereafter, have a genuine intention of holding their GEI Securities until such time as they derive assessable income (other than capital gains) from the investment that exceeds the deductible expenditure incurred in connection with the investment.

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

- do not, at the time of entering into the scheme and on each Interest Payment Date thereafter, have a genuine intention of holding their GEI Securities until such time as they derive assessable income (other than capital gains) from the investment that exceeds their deductible expenditure
- hold GEI Securities that are non-income-producing
- are accepted to participate in the scheme described in paragraphs 16 to 20 of this Product Ruling before 1 July 2022<sup>2</sup> or after 30 June 2025
- participate in the scheme through offers made other than through the Product Brochure, or enter into an undisclosed arrangement with the promoter or a promoter associate, or an independent adviser that is interdependent with scheme obligations or scheme benefits (which may include tax benefits) in any way
- have their GEI loan advanced against GEI Securities that the investor already holds
- fail to give the required instructions regarding which GEI Securities to acquire such that clause 1.4(e) of the Loan and Security Agreement is activated and the Facility is terminated
- are not both the Owner and Borrower as defined in clause 27.17 of the Loan and Security Agreement, or
- are subject to Division 230 in respect of this scheme.

### 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.

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<sup>2</sup> Investors that are accepted to participate in the scheme on or after 11 November 2019 and prior to 1 July 2022 may be able to rely on Product Ruling PR 2020/1 *Income tax: tax consequences of investing in equities using Bell Geared Equities Investment (2019 Product Brochure)*.

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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 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 during the period of application.

11. However, the Product Ruling only applies to the extent that there is no change in the scheme or in the entity's involvement in the scheme.

#### **Changes in the law**

12. Although this Product Ruling deals with the income tax laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such change 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.

## **Ruling**

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15. Subject to paragraphs 3 and 4 of this Product Ruling and the assumptions in paragraph 20 of this Product Ruling:

- (a) In relation to the GEI loan, Division 247 will apply to treat the excess (if any) calculated under the method statement in subsection 247-20(3) as being reasonably attributable to the cost of capital protection for the income year.
- (b) Under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection under Division 247 in an income year is the amount by which the expense incurred for interest on the GEI loan exceeds
  - where the interest rate charged by BPC is a fixed rate for all or part of the term of the loan and that fixed rate is applicable to the loan for all or part of the income year, the amount of the loan multiplied by the sum of the Reserve Bank of Australia's Indicator Lending Rate

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- for Standard Variable 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 loan, or the relevant part of the term (subsections 247-20(4) and (5)), and
- where the interest rate charged by BPC is a variable rate for all or part of the term of the loan and a variable rate is applicable to the loan for all or part of the income year, the amount of the loan multiplied by the average of the adjusted loan rates applicable during those parts of the income year when the loan is at a variable rate (subsections 247-20(5) and (5A)).
- (c) The amount reasonably attributable to the cost of capital protection under Division 247, as worked out under paragraph 15(b) of this Product Ruling, is treated as the cost of one or more put options (Put Options) granted by BPC to the investor under subsection 247-20(6). This amount is not deductible under section 8-1.
- (d) Interest incurred under the GEI loan, reduced by the cost of the Put Option, will be deductible under section 8-1 to the extent that it does not correspond to the part of the GEI loan that is used to fund a brokerage fee.
- (e) Section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny the investor a deduction for the interest incurred under the GEI loan that is allowable as a deduction under section 8-1.
- (f) Section 82KL of the ITAA 1936 will not apply to deny the investor a deduction for the interest incurred under the GEI loan that is allowable as a deduction under section 8-1.
- (g) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for any prepaid interest incurred under the GEI loan that is allowable as a deduction under section 8-1.
- (h) Section 82KZM of the ITAA 1936 will not apply to deny the investor immediate deductibility of any part of any prepaid interest incurred on the GEI loan that is allowable as a deduction under section 8-1.
- (i) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for any prepaid interest incurred under a GEI loan that is allowable as a deduction under section 8-1 to an investor (other than a small business entity, or an entity covered by subsection 82KZMA(2A) of the ITAA 1936, that has not chosen to apply section 82KZMD to the expenditure) that is not an individual and does not carry on a business.
- (j) If an investor does not exercise a Put Option by the Final Maturity Date
- the Put Option will expire (subsection 247-30(2))
  - CGT event C2 under section 104-25 will happen in relation to the Put Option for the investor, resulting in a capital loss equal to the reduced cost base of that Put Option under subsection 104-25(3), and
  - pursuant to subsection 110-55(2), the reduced cost base of the Put Option will include the proportion of the total cost of the Put Options that is reasonably attributable to that Put Option.

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- (k) If an investor exercises a Put Option in relation to a GEI Security at the end of the GEI loan term, the cost of the Put Option will be included in the second element of the cost base and the reduced cost base of that GEI Security pursuant to table item 2 in subsection 134-1(1). Any capital gain or capital loss the investor makes from exercising a Put Option will be disregarded under subsection 134-1(4).
- (l) If an investor repays the GEI loan and sells GEI Securities to fund the repayment, CGT event A1 will happen under section 104-10. The investor will make a capital gain on selling the GEI Securities equal to the capital proceeds less the cost base of the GEI Securities.
- (m) Any Loan Establishment Fee paid by an investor is deductible under section 25-25 over the term of the GEI loan.
- (n) Where the scheme is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny the deductibility of the interest or the Loan Establishment Fee incurred by the investor in respect of a GEI loan.

## Scheme

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16. 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 9 June 2022 and 1 July 2022
- Bell Geared Equities Investment Product Brochure dated 11 November 2019, including a Web Update dated 4 October 2021 and the Loan and Security Agreement, and
- Bell Geared Equities Investment Application for Finance Form dated 11 November 2019.

**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 GEI loan are summarised as follows:

- (a) Under the scheme, investors borrow funds from BPC to finance the purchase of GEI Securities and brokerage. The GEI Securities are shares, units in certain widely held trusts or stapled securities listed on the Australian Securities Exchange (ASX), or units in trusts that are registered managed investment schemes in accordance with section 601EB of the *Corporations Act 2001*, including units in an

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- approved Cash Trust. Where the GEI Security is a stapled security, the stapled security comprises shares and units that are jointly listed for quotation on the ASX.
- (b) The investors are required to select GEI Securities from an approved list of GEI Securities which is available on the GEI website, up to the amount of funds borrowed from BPC less brokerage. The minimum Loan Amount is \$50,000, and the minimum size for each parcel of GEI Securities is \$10,000.
  - (c) An investor may select their own combination of GEI Securities to form a portfolio but no more than 50% of the value of the portfolio of GEI Securities selected by the investor may consist of units in a managed investment scheme (including units in an approved Cash Trust). 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, BPC), as determined by BPC from time to time.
  - (d) At the investor's option, the term of the GEI loan may be one, 2, 3 or 4 years. Interest is payable monthly in arrears on a variable basis or annually in advance at a rate fixed for one or more years.
  - (e) BPC will calculate a different rate of interest for each GEI Security an investor may invest in. The interest rate will be quoted and reported to an investor as a single consolidated rate taking into account all of the GEI Securities held. The interest rate will also depend upon the term of the GEI loan. Generally, the shorter the period of the GEI loan and the greater the risk to BPC given the security offered by the GEI Securities, the higher the rate of interest charged. The inclusion in the portfolio of GEI Securities of units in an approved Cash Trust is likely to result in a lower interest rate on the GEI loan compared to a portfolio of GEI Securities which does not include units in an approved Cash Trust.
  - (f) A Loan Establishment Fee of up to 3% of the GEI loan may be charged by BPC at its discretion, and is payable in full on the day the loan is advanced. Where a Loan Establishment Fee is charged this will generally result in a lower interest rate on the GEI loan than if the Loan Establishment Fee had not been charged.
  - (g) For the purpose of securing the rights of BPC under the GEI loan, the investor, as legal and beneficial owner (or where the investor is a trustee of a trust, as legal owner) of the GEI Securities, grants a Mortgage to BPC over the acquired GEI Securities and related rights.
  - (h) The Loan and Security Agreement provides for a limited recourse facility by BPC in relation to the investor. As such, BPC is only entitled to enforce its rights as mortgagee in relation to the principal of the GEI loan against the GEI Securities held as security.
  - (i) The limited recourse loan facility operates to limit the investor's liability under the GEI loan to the GEI Securities and operates as a mechanism of capital protection. If requested to do so by the investor, BPC will exercise its rights under the Mortgage at the Final Maturity Date where the market value of the investor's GEI Securities (or of one or more types of GEI Securities) has fallen below the acquisition cost of those GEI Securities. BPC is entitled to set-off the payment of that price against the obligations of the investor to repay the GEI loan in respect of the GEI Securities (or a type of GEI



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- Securities). The investor will have no further obligation to BPC in respect of the GEI loan (or the portion of the GEI loan in respect of a respective type of GEI Securities).
- (j) The investor is not required to pay a separate fee for the limited recourse loan facility.
  - (k) The investor shall repay the GEI loan to BPC in one amount on the Final Maturity Date. At least five clear Business Days before the Final Maturity Date, the investor must inform BPC whether
    - (i) the investor will repay all or part of the GEI loan on the Final Maturity Date
    - (ii) the investor intends to activate the limited recourse loan facility in respect of all or part of the GEI loan on the Final Maturity Date, and
    - (iii) the investor intends to roll their GEI Securities into a new GEI Facility for another term.
  - (l) Any Distributions paid in respect of the GEI Securities acquired under the scheme are paid to the investor, although in some circumstances the investor may be required to reinvest the Distributions to acquire further GEI Securities of the same type.
  - (m) Any Further Securities acquired or bonus securities issued will form part of the security for the GEI loan. At the expiry of the GEI loan, should the market value of the Initial Securities, and any bonus or Further Securities, be below the cost of the original parcel of GEI Securities, the original plus any bonus or Further Securities may be subject to the limited recourse loan facility.

### 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 investors are not traders in investments and are not treated for tax purposes as trading in the GEI Securities, carrying on a business of investing in the GEI Securities or holding GEI Securities as trading stock or as revenue assets.
  - (c) In respect of any interest charges to be paid in advance under the GEI loan, these may be prepaid only in relation to a loan interest payment period of 12 months or less and which ends on or before the last day of the income year following the expenditure year.
  - (d) At the time of any interest prepayment, where the GEI Securities include units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936.
  - (e) Where the GEI Securities acquired by an investor include units in a trust, it is reasonable to expect that the investor will derive trust income from those units.
  - (f) The dominant purpose of an investor in entering the scheme is to derive an amount of receipts (income, gains and distributions) from their GEI

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Securities acquired under the scheme that exceeds the total expenses incurred in respect of the GEI loan.

- (g) The scheme will be executed in the manner described in the Scheme section of this Product Ruling and in accordance with the scheme documentation mentioned in paragraph 16 of this Product Ruling.
- (h) All dealings between the Investor and BPC will be at arm's length.

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**Commissioner of Taxation**

31 August 2022

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## Appendix – Explanation

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**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.*

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### **Section 8-1 and Division 247**

21. Interest paid on a borrowing used to acquire income-producing assets such as shares or units is generally treated as deductible under section 8-1 where it is expected that dividends or other assessable income would be derived from the investment (refer to 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.

22. 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.

23. Division 247 applies to the GEI loan where the investor uses the GEI loan to acquire GEI Securities and the investor is protected against the fall in the market value of the GEI Securities (or of one or more types of GEI Securities).

24. Division 247 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a capital protected borrowing (section 247-20). 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).

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25. The amount reasonably attributable to the cost of capital protection afforded by the GEI loan is worked out according to the method statement in subsection 247-20(3) as set out in paragraph 15(b) of this Product Ruling. This amount is treated as the cost of one or more of the investor's Put Options under subsection 247-20(6).

26. Each Put Option is a capital asset. As the cost of capital protection is the cost of the investor's Put Options, this expense is capital in nature. The interest charged on the GEI loan will be deductible under section 8-1 only to the extent that it does not constitute the cost of capital protection (and does not correspond to the part of the GEI loan that is used to fund a brokerage fee).

#### **Section 51AAA of the ITAA 1936**

27. Under the scheme it is contemplated that over the period of an investor's involvement there will be assessable income derived by way of dividend income or trust income, or both, as well as by way of capital gain. As the interest 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 in the scheme.

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

28. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefits'. 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.

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

29. Subdivision H of Division 3 of Part III 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 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 of the ITAA 1936***

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

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- 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***

31. The interest charge under the GEI loan that is deductible under section 8-1 may 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 of the ITAA 1936, 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 of the ITAA 1936 – 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 of the ITAA 1936, 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), the relevant ‘agreement’ is all the contractual arrangements and activities associated with the participation in the scheme, including the financing, share or unit purchase, share or unit holding and disposal arrangements.

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

- the prepaid interest expenditure under the GEI loan is incurred in respect of money borrowed to acquire GEI Securities that are listed for quotation on the ASX or units in a trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936
- the investor can reasonably be expected to obtain dividends or trust income or both from the investment
- the investor will not obtain any other kind of assessable income from the investment, except for capital gains, and
- all aspects of the scheme are at arm’s length.

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

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***Section 82KZM of the ITAA 1936 – prepaid expenditure incurred by certain small and medium 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, or an entity covered by subsection 82KZM(1A) 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, 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.

38. As the eligible service period in relation to the deductible interest payments for the GEI 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 referred to in paragraph 36 of this Product Ruling. Such investors will be able to claim an immediate deduction for any prepaid interest amount incurred on the GEI loan that is allowable as a deduction under section 8-1.

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

39. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure incurred by an investor (other than a small business entity or an entity covered by subsection 82KZMA(2A) of the ITAA 1936<sup>4</sup>, 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 on the GEI loan and 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 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 30 of this Product Ruling) were instead a reference to \$50 million).

<sup>4</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 in section 328-110 to \$10 million (as noted in paragraph 30 of this Product Ruling) were instead a reference to \$50 million).

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### **Division 110 – cost base of the Put Options**

42. The cost of capital protection is not deductible to the investor under section 8-1 (refer to paragraph 15(c) of this Product Ruling) and is included in the first element of the cost base (under subsection 110-25(2)) and the reduced cost base (under subsection 110-55(2)) of a Put Option acquired by the investor. Each Put Option constitutes a CGT asset, and is separate and in addition to the other rights created under the scheme as described in this Product Ruling.

43. As a single interest rate applies in respect of the GEI loan, including where more than one type of GEI Security is held, the investment will be treated as one arrangement for the purposes of Division 247. As capital protection may be invoked in respect of each type of GEI Security a separate Put Option is deemed to be provided in respect of each type of GEI Security acquired with the GEI loan. The cost of capital protection will therefore need to be reasonably apportioned to each Put Option. The proportion of the cost of capital protection that is reasonably attributable to each Put Option is the cost of each type of GEI Security acquired with the GEI loan divided by the cost of all of the GEI Securities acquired with the GEI loan, multiplied by the cost of capital protection.

44. If the investor exercises a Put Option at the end of the GEI loan term by relying on the limited recourse provisions of the loan in relation to a type of GEI Security, the investor will include the payment they are deemed to have made to acquire the Put Option in the second element of the investor's cost base and reduced cost base of the GEI Security disposed of by BPC (on behalf of the investor) under its rights as mortgagee, pursuant to table item 2 of subsection 134-1(1). Any capital gain or capital loss the investor makes from exercising a Put Option is disregarded under subsection 134-1(4).

45. Although the sale proceeds will be insufficient to repay the GEI loan, BPC will have no recourse against the investor to recover the shortfall. In this circumstance, the investor will need to reduce the cost base (under subsection 110-45(3)) and the reduced cost base (under subsection 110-55(6)) of the GEI Security by the amount of the shortfall. The combined effect will be to give rise to a capital loss equal to, at the very least, the cost base of the Put Option.

46. If the investor does not exercise a Put Option by the Final Maturity Date, the Put Option will be taken to have expired under subsection 247-30(2). This will cause CGT event C2 to happen pursuant to paragraph 104-25(1)(c). The investor will make a capital loss at that time, equal to the reduced cost base of the Put Option. This will occur where:

- (a) the investor disposes the GEI Securities and repays the GEI loan at the Final Maturity Date, and the capital proceeds are higher than the balance of the GEI loan – this would also cause CGT event A1 to happen to the investor in respect of the GEI Securities under section 104-10, or
- (b) the investor repays the GEI loan at the Final Maturity Date, whether from other existing funds or by refinancing, so that the investor retains ownership of the GEI Securities.

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

47. Any Loan Establishment Fee incurred by an investor upon successful application for the GEI loan will be an allowable deduction pursuant to section 25-25. The Loan Establishment Fee will be deductible on a straight line basis over the term of the GEI loan.

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Status: **not legally binding**

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## References

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### *Related Rulings/Determinations:*

TR 95/33; PR 2020/1

### *Legislative references:*

- ITAA 1997 104-25
  - ITAA 1997 104-25(1)(c)
  - ITAA 1997 104-25(3)
  - ITAA 1997 Div 110
  - ITAA 1997 110-25(2)
  - ITAA 1997 110-45(3)
  - ITAA 1997 110-55(2)
  - ITAA 1997 110-55(6)
  - ITAA 1997 134-1(1)
  - ITAA 1997 134-1(4)
  - ITAA 1997 Div 230
  - ITAA 1997 Div 247
  - ITAA 1997 247-20
  - ITAA 1997 247-20(3)
  - ITAA 1997 247-20(4)
  - ITAA 1997 247-20(5)
  - ITAA 1997 247-20(5A)
  - ITAA 1997 247-20(6)
  - ITAA 1997 247-30(2)
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  - ITAA 1936 82KZM(1A)
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  - ITAA 1997 8-1
  - ITAA 1997 25-25
  - ITAA 1997 104-10
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