


PR 2023/14 - National Australia Bank Tailored Equity Solutions Facility

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Status: **legally binding**

Product Ruling

National Australia Bank Tailored Equity Solutions Facility

📌 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.

Terms of use of this Ruling

This Ruling has been given on the basis that the entity who applied for the 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 Ruling.

Changes in the law

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 promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling has issued. Similarly, 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 Ruling since it was issued.

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.

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What this Ruling is about

1. This 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 Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.
2. In this Ruling, the scheme is referred to as the National Australia Bank Tailored Equity Solutions Facility (Facility) offered by National Australia Bank Limited (NAB) under the NAB Tailored Equity Solutions Facility Information Memorandum (IM).¹
3. This Ruling does not address:
 - the tax consequences of
 - the early termination of a Protected Equity Loan (PEL) (including a Portfolio Protected Equity Loan (PPEL))², Linked Loan, Linked Put Option or Linked Collar Option
 - a repayment of a PEL or Linked Loan before the relevant Maturity Date, including any refunded prepaid interest
 - the amendment of the terms of a PEL or Linked Loan as a result of an Extraordinary Event
 - a PEL or Linked Loan drawn against Underlying Securities that an investor already holds
 - a Linked Loan applied to pay the Option Premium or the Fixed Option Premium
 - a PEL or Linked Loan to which a Variable Interest Rate applies
 - a PEL or Linked Loan used to acquire Underlying Securities listed on an exchange outside of Australia
 - refinancing a maturing PEL with a new PEL or a maturing Linked Loan with a new Linked Loan
 - selling Options
 - buying Options other than a Linked Put Option or Linked Collar Option
 - an Index Option or an Option exercisable as an American Option
 - a NAB Equity Referenced Term Investment
 - a Dividend Agreement (or any other Additional Transaction made available under the Facility)
 - income derived from the Underlying Securities, and
 - paying any fees and costs under the Facility (other than interest, the Loan Establishment Fee, the Option Premium, the Fixed Option Premium and the Variable Option Premium)
 - an investor's entitlement to franking credits, and

¹ Unless otherwise defined, capitalised terms in this Ruling take their meaning from the IM referred to in paragraph 11 of this Ruling.

² Unless the contrary intention appears, a reference in this Ruling to 'PEL' includes a reference to a 'PPEL', as referred to in paragraph 17 of this Ruling.

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- whether this scheme constitutes a financial arrangement for the purposes of Division 230 (taxation of financial arrangements).
4. Subject to paragraph 3 of this Ruling, this Ruling addresses the tax consequences associated with the following scenarios:
- the procurement of a PEL, and
 - the procurement of a loan (a Linked Loan) that is linked to a purchased Put Option or Collar (a Linked Put Option or Linked Collar Option).

Who this Ruling applies to

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 in this Product Ruling as the investor.

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 11 to 48 of this Ruling on or after 9 August 2023 and on or before 30 June 2026, and
- at the time of entering into the scheme have a
 - purpose of remaining in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and
 - genuine intention of holding their Underlying Securities to derive assessable income from the Underlying Securities (other than capital gains), whether during the term of the PEL or Linked Loan or after the PEL or Linked Loan is repaid, 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:

- are non-residents for Australian tax purposes
- at the time of entering into the scheme intend to terminate their investment in the scheme prior to its completion
- do not, at the time of entering into the scheme, have a genuine intention of holding their Underlying Securities to derive assessable income from the Underlying Securities (other than capital gains) that exceeds the deductible expenditure that they incur in connection with the investment
- subsequent to the time of entering into the scheme develop a principal purpose in relation to the scheme of claiming deductions for interest payable under the scheme
- are accepted to participate in the scheme described in paragraphs 11 to 48 of this Ruling before 9 August 2023 or after 30 June 2026
- acquire a PEL or Linked Loan in respect of Underlying Securities that the investor already holds

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- participate in the scheme through offers made other than through the IM, or that 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
- trade in securities and are treated for tax purposes as trading in securities, carrying on a business of investing in securities, or holding the Underlying Securities as trading stock or as revenue assets
- trade in options or collars and are treated for tax purposes as trading in options or collars, carrying on a business of investing in options or collars, or holding a Linked Put Option or Linked Collar Option as trading stock or as a revenue asset
- invest through an investor directed portfolio service, or
- are subject to Division 230 in respect of this scheme.

Date of effect

8. This Ruling applies prospectively from 9 August 2023, the date it is published. It applies only to the specified class of entities that enter into the scheme from 9 August 2023 until 30 June 2026, being its period of application. This 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.

9. However, the Ruling only applies and may be relied on to the extent that there is no change in the scheme or in the entity's involvement in the scheme. If the scheme carried out is materially different from the scheme described at paragraphs 11 to 48 of this Ruling, this Ruling cannot be relied upon and may be withdrawn or modified.

Ruling

10. Subject to paragraph 3 of this Ruling and the assumptions in paragraph 48 of this Ruling:

- (a) Where the investor has a PEL
 - (i) the interest incurred under the PEL, reduced by an amount reasonably attributable to the cost of capital protection worked out under step 3 of the method statement in subsection 247-20(3), will be deductible under section 8-1
 - (ii) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the interest incurred under the PEL for the income year exceeds the amount of the PEL multiplied by the sum of the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans – Investor and 100 basis points (the 'adjusted loan rate') at the time when the interest charge is first incurred during the term of the PEL, or the relevant part of the term (subsections 247-20(4) and (5)), and

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- (iii) the amount reasonably attributable to the cost of capital protection as worked out under sub-subparagraph 10(a)(ii) of this Ruling, is treated as part of the cost of a put option under subsection 247-20(6). This amount is not deductible under section 8-1.
- (b) Where the investor has a Linked Loan that is linked to a purchased Put Option or Collar
 - (i) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the total of the Option Premium or Fixed Option Premium paid during that income year (as applicable) and interest incurred under the Linked Loan for the income year exceeds the amount of the Linked Loan multiplied by the adjusted loan rate at the time when the interest charge is first incurred during the term of the Linked Loan, or the relevant part of the term (subsections 247-20(4) and (5))
 - (ii) the amount reasonably attributable to the cost of capital protection as worked out under sub-subparagraph 10(b)(i) of this Ruling, reduced by the Option Premium or the Fixed Option Premium (as applicable), is treated as a further cost of the Linked Put Option or Linked Collar Option under subsection 247-20(6). For the purposes of this Ruling, this further cost of the Linked Put Option or Linked Collar Option is referred to as the 'additional amount'
 - (iii) the additional amount (if any) and any Option Premium or Fixed Option Premium paid are not deductible under section 8-1, and
 - (iv) an amount equal to the interest incurred under the Linked Loan, reduced by the additional amount (if any), will be deductible under section 8-1.
- (c) 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 PEL or the Linked Loan that is allowable as a deduction under section 8-1.
- (d) Section 82KL of the ITAA 1936 will not apply to deny the investor a deduction for the interest incurred under the PEL or the Linked Loan that is allowable as a deduction under section 8-1.
- (e) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for any prepaid interest incurred under the PEL or the Linked Loan that is allowable as a deduction under section 8-1.
- (f) Section 82KZM of the ITAA 1936 will not apply to deny the investor immediate deductibility of any part of any prepaid interest incurred under the PEL or the Linked Loan that is allowable as a deduction under section 8-1.
- (g) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for any prepaid interest incurred under the PEL or the Linked 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 of the ITAA 1936 to the expenditure) that is not an individual and does not carry on a business.

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- (h) If the investor procures a PEL and the limited recourse provisions of the PEL are invoked at the Maturity Date
 - (i) CGT event A1 under section 104-10 will happen in relation to the Underlying Securities for the investor
 - (ii) pursuant to subsection 134-1(1), the cost base and reduced cost base of the Underlying Securities will include the amount reasonably attributable to the cost of capital protection (if any) calculated under sub-subparagraph 10(a)(ii) of this Ruling, and
 - (iii) any capital gain or capital loss made by the investor on exercise of the put option referred to in sub-subparagraph 10(a)(iii) of this Ruling will be disregarded under subsection 134-1(4).
- (i) If the investor procures a PEL and the limited recourse provisions of the PEL are not invoked at the Maturity Date
 - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the put option referred to in sub-subparagraph 10(a)(iii) of this Ruling for the investor, resulting in a capital loss equal to the reduced cost base of that put option under subsection 104-25(3), and
 - (ii) pursuant to section 110-55, the reduced cost base of the put option referred to in sub-subparagraph 10(a)(iii) of this Ruling will include the amount reasonably attributable to the cost of capital protection (if any) calculated under sub-subparagraph 10(a)(ii) of this Ruling.
- (j) If the investor procures a Linked Loan, the Market Price of the Underlying Securities on the Expiry Date is below or equal to the Exercise Price and the investor's Linked Put Option or Linked Collar Option is exercised, under a Physical Settlement
 - (i) CGT event A1 under section 104-10 will happen in relation to the Underlying Securities for the investor
 - (ii) pursuant to subsection 134-1(1), the cost base and reduced cost base of the Underlying Securities will include the Option Premium or Fixed Option Premium paid (as applicable) and the additional amount (if any) calculated under sub-subparagraph 10(b)(ii) of this Ruling, and
 - (iii) any capital gain or capital loss made by the investor on exercise of the Linked Put Option or Linked Collar Option will be disregarded under subsection 134-1(4).
- (k) If the investor procures a Linked Loan, the Market Price of the Underlying Securities on the Expiry Date is below or equal to the Exercise Price and the investor's Linked Put Option or Linked Collar Option is exercised, under a Cash Settlement
 - (i) CGT event C2 under paragraph 104-25(1)(e) will happen in relation to the Linked Put Option or Linked Collar Option for the investor, and
 - (ii) pursuant to sections 110-25 and 110-55, the cost base and the reduced cost base of the Linked Put Option or Linked Collar Option will include the Option Premium or Fixed Option Premium paid (as applicable), and the additional amount (if any) calculated under sub-subparagraph 10(b)(ii) of this Ruling.

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- (l) If the investor procures a Linked Loan, the Market Price of the Underlying Securities on the Expiry Date is above the Exercise Price but, in the case of a Linked Collar Option, below the Cap Price, and the investor's Linked Put Option or Linked Collar Option expires unexercised
 - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the Linked Put Option or Linked Collar Option for the investor, resulting in a capital loss equal to the reduced cost base of the Linked Put Option or Linked Collar Option under subsection 104-25(3), and
 - (ii) pursuant to section 110-55, the reduced cost base of the Linked Put Option or Linked Collar Option will include the Option Premium or Fixed Option Premium paid (as applicable) and the additional amount (if any) calculated under sub-subparagraph 10(b)(ii) of this Ruling.
- (m) If the investor procures a Linked Loan, the Market Price of the Underlying Securities on the Expiry Date is above or equal to the Cap Price and the investor's Linked Collar Option expires unexercised
 - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the Linked Collar Option for the investor, resulting in a capital loss equal to the reduced cost base of the Linked Collar Option under subsection 104-25(3), and
 - (ii) pursuant to section 110-55, the reduced cost base of the Linked Collar Option will include the Fixed Option Premium paid, the Variable Option Premium paid and the additional amount (if any) calculated under sub-subparagraph 10(b)(ii) of this Ruling.
- (n) Any capital gain realised by an investor on the sale of Underlying Securities or exercise of the Linked Put Option or Linked Collar Option under a Cash Settlement will be treated as a discount capital gain under section 115-5 where the investor is an individual or a trust and the sale or exercise occurs more than 12 months after the date of acquisition of the Underlying Securities, Linked Put Option or Linked Collar Option (as applicable).
- (o) Any Fixed Option Premium paid to the investor by NAB in respect of a Linked Collar Option will be capital proceeds of the investor under section 116-20 from creating a contractual right in NAB to be paid the Variable Option Premium under the Linked Collar Option where the Market Price of the Underlying Securities on the Expiry Date is above or equal to the Cap Price.
- (p) Division 230 will not apply to any gains or losses with respect to the Facility where the investor is excepted from the Division pursuant to section 230-455.
- (q) Any Loan Establishment Fee paid by an investor is deductible under section 25-25 over the term of the PEL or Linked Loan.
- (r) Where the scheme is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny deductibility of the interest or the Loan Establishment Fee incurred by the investor in respect of the PEL or Linked Loan.

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Scheme

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

- application for a product ruling as constituted by information and documentation received on 10 February 2023 and 13 June 2023, and
- draft NAB Tailored Equity Solutions Facility Information Memorandum, including the draft NAB Equity Solutions Master Agreement, received on 13 June 2023.

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

12. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements (whether formal or informal, and whether or not legally enforceable) which an investor, or any associate of an investor, will be a party to which are a part of the scheme.

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

14. An eligible investor, being an individual, partnership, company or trustee and a wholesale investor within the meaning of section 761G of the *Corporations Act 2001*, must complete and sign the Application Form to establish a Facility. Upon acceptance by NAB of an investor's Application Form, NAB will execute the Master Terms on the investor's behalf and the investor is able to request entry to a Transaction offered under the Facility, including a PEL Transaction and a Linked Loan Transaction.³

15. Having received the request for entry to a Transaction, NAB will prepare a Quote on the basis of the investor's specified parameters, setting out indicative financial terms of the Transaction. Where the investor accepts the Quote, NAB books the Transaction and provides the investor with a Confirmation, setting out the agreed terms for the Transaction. Upon the booking of the Transaction by NAB, the investor will be contractually bound to the terms of the Confirmation, together with the Master Terms.

Protected Equity Loan

16. The PEL is an interest only, limited recourse loan of at least \$50,000 (unless otherwise agreed by NAB) which may be obtained from NAB to finance up to 100% of the purchase price of a parcel of identical Underlying Securities (that is, securities issued by the same issuing entity and with identical characteristics).

17. Where the investor wishes to enter into multiple PELs with the same Drawdown Date, Maturity Date and loan to value ratio, each one used to finance up to 100% of the purchase price of a different parcel of identical Underlying Securities, they may request to treat such PELs as a PPEL.

18. Where the PEL finances less than 100% of the relevant purchase price, the investor is required to contribute their own funds towards the purchase price equal to the difference between the total cost of purchasing the Underlying Securities and the amount of the PEL.

³ Neither the PEL or Linked Loan is available to the trustee of a Superannuation Fund.

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19. The Underlying Securities are selected by the investor, subject to NAB's discretion. Underlying Securities are expected to include securities that are listed for quotation on the Australian Securities Exchange and admitted to the S&P/ASX 200 Index and select Exchange Traded Funds and Approved Cash Trusts.

20. A unit in an Approved Cash Trust is a managed investment scheme interest in a cash management trust which is quoted for trading on an Approved Exchange and approved by NAB. The Underlying Securities purchased with a PEL other than a PPEL cannot be units in an Approved Cash Trust. No more than 50% of a PPEL will be used to acquire units in Approved Cash Trusts.

21. The term of a PEL can range from one month to 5 years. Interest on the Amount Owing under a PEL is payable in advance on each Interest Payment Date specified in the Confirmation. Interest for a PEL with a term of less than one year is payable on the Drawdown Date. PELs with a term of greater than one year are made up of multiple interest periods each of 12 months or less.

22. The Interest Rate applicable to a PEL will be generally fixed and determined by NAB taking into account a number of factors including the identity of the Underlying Securities, the investor's loan to value ratio, the Term of the PEL and NAB's internal cost of funding. Different Interest Rates may apply to PELs used to acquire different Underlying Securities.

23. The Interest Rate applicable to a PPEL will be a single blended Interest Rate determined by NAB taking into account, among other things, the total cost to NAB of lending amounts to the investor in respect of the different Underlying Securities. The inclusion of units in Approved Cash Trusts in the portfolio acquired using the investor's PPEL will lower the blended Interest Rate on the PPEL.

24. A Loan Establishment Fee of up to 3% of the Loan Amount may be charged by NAB at its discretion, and is payable in full on the day the PEL is advanced.

25. The Underlying Securities will be held by the investor in a CHESS sponsored account in the investor's name. As security for the PEL, the investor must grant a security interest to NAB over the Secured Property, including all rights and proceeds in respect of the Underlying Securities held in the CHESS sponsored account. As further security, NAB may require a Guarantor to guarantee the obligations of the investor under the PEL.

26. The legal and beneficial interest in the Underlying Securities will be held by the investor at all times during the term of the PEL.

27. The PEL will be limited recourse at the Maturity Date. This means that NAB's right of recourse against the investor for repayment of the Loan Amount on the Maturity Date is limited to the amount which NAB can obtain by enforcing its rights in respect of the Secured Property securing the PEL. NAB's rights of recourse against an investor (or any Guarantor) are not limited in respect of the investor's obligation to pay interest or any other amounts under the PEL.

28. Under a PPEL, NAB's recourse for repayment of each Loan Amount on the Maturity Date is limited to the amount NAB can obtain by enforcing its rights in respect of the Secured Property securing each respective Loan Amount. This means there will be no offsetting of gains from one parcel of Underlying Securities in the portfolio that comprises the investor's PPEL against losses from another parcel of Underlying Securities.

29. The consideration for this capital protection feature under the PEL is factored into the Interest Rate charged against the PEL.

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30. Five Business Days prior to the Maturity Date, the investor must notify NAB whether the investor:

- will repay the Loan Amount on the Determination Date (being 2 Business Days prior to the Maturity Date) and retain the Underlying Securities
- wishes to enter into a new PEL to refinance the maturing PEL
- intends to activate the limited recourse feature in respect of the PEL, where the Underlying Securities on the Determination Date is insufficient to repay the Loan Amount in full, so that NAB will sell the Underlying Securities for the Market Price on the Determination Date on the investor's behalf and apply the sale proceeds in full satisfaction of the Loan Amount on the Maturity Date, or
- wishes for NAB to sell the Underlying Securities for the Market Price on the Determination Date on the investor's behalf and have any remaining sale proceeds, after repaying the Loan Amount and any other outstanding amounts relating to the PEL, credited to the investor on the Maturity Date.

31. Where the investor does not repay the Loan Amount on the Determination Date or NAB does not approve the investor's request to refinance, NAB will sell the Underlying Securities on the investor's behalf and use the sale proceeds to repay the Loan Amount and any other outstanding amounts relating to the PEL. Any excess remaining from the sale proceeds will be credited to the investor.

Linked Loan with Linked Put Option or Linked Collar Option

32. The Linked Loan is an interest only, limited recourse loan of at least \$50,000 (unless otherwise agreed by NAB) which may be obtained from NAB to finance up to 100% of the purchase price of a parcel of identical Underlying Securities. Where the Linked Loan finances less than 100% of the relevant purchase price, the investor is required to contribute their own funds towards the purchase price equal to the difference between the total cost of purchasing the Underlying Securities and the amount of the Linked Loan.

33. The Underlying Securities are selected by the investor, subject to NAB's discretion. Underlying Securities are expected to include securities that are listed for quotation on the Australian Securities Exchange and admitted to the S&P/ASX 200 Index and select Exchange Traded Funds.

34. Interest on the Amount Owing under a Linked Loan is payable on the same basis as under a PEL and the Interest Rate applicable under a Linked Loan will generally be fixed and determined on the same basis as for a PEL (see paragraphs 21 and 22 of this Ruling). A Loan Establishment Fee of up to 3% of the Loan Amount may be charged by NAB at its discretion, and is payable in full on the day the Linked Loan is advanced.

35. To draw down on the Linked Loan, the investor must purchase or have previously purchased an Option that is eligible to become a Linked Option, that is, a Put Option or Collar Option which are then treated as a Linked Put Option or a Linked Collar Option respectively.

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36. The Linked Put Option or Linked Collar Option provides the investor with the right to sell the Underlying Securities to NAB at the Exercise Price where the Market Price of the Underlying Securities on the Expiry Date is less than or equal to the Exercise Price and the Option is exercised. Where the Market Price of the Underlying Securities on the Expiry Date is above the Exercise Price, the Linked Put Option or Linked Collar Option will expire unexercised.

37. The cost of a Linked Put Option will be the Option Premium. The cost of a Linked Collar Option will be the sum of the Fixed Option Premium (if any) and the Variable Option Premium (if any).

38. The Option Premium or the Fixed Option Premium, as applicable, is determined by NAB taking into account a number of factors including the Exercise Price relative to the Market Price of the Underlying Securities at the time the Option is purchased, the expected volatility and distribution yield of the Underlying Securities, the term of the Option and interest rates.

39. The Variable Option Premium must be paid in the event the Market Price of the Underlying Securities on the Expiry Date is above or equal to the Cap Price and will be equal to the excess of the Market Price of the Underlying Securities at the Expiry Date over the Cap Price.

40. Depending on where the Exercise Price and Cap Price relating to a Linked Collar Option are established, the Fixed Option Premium may instead be payable by NAB to the investor.

41. The term of a Linked Loan can range from one month to 5 years but cannot exceed the Settlement Date of the Linked Put Option or Linked Collar Option, as applicable.

42. As security for the Linked Loan, the investor must grant a security interest to NAB over the Secured Property, including all rights and proceeds in respect of the Underlying Securities related to the Linked Put Option or Linked Collar Option and held by the investor in a CHESS sponsored account in the investor's name. As further security, NAB may require a Guarantor to guarantee the obligations of the investor under the Linked Loan.

43. The legal and beneficial interest in the Underlying Securities will be held by the investor at all times during the term of the Linked Loan.

44. Put Options are available for purchase under the Facility as European Options and American Options whereas Collar Options are only available for purchase as European Options. Where the investor purchases a Linked Put Option that is a European Option or a Linked Collar Option, the Linked Loan will be limited recourse at the Maturity Date. This means that NAB's right of recourse against the investor for repayment of the Loan Amount on the Maturity Date is limited to the amount which NAB can obtain by enforcing its rights in respect of the Secured Property securing the Linked Loan. NAB's rights of recourse against an investor (or any Guarantor) are not limited in respect of the investor's obligation to pay interest or any other amounts under the Linked Loan.

45. The Linked Put Option and Linked Collar Option may be settled by Physical Settlement or Cash Settlement, as specified in the Confirmation.

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46. Five Business Days prior to the Expiry Date in respect of the Linked Put Option or Linked Collar Option, the investor must notify NAB whether the investor:
- will repay the Loan Amount on the Expiry Date and retain the Underlying Securities
 - wishes to enter into a new Linked Loan to refinance the maturing Linked Loan
 - intends to do nothing, where the value of the Underlying Securities on the Expiry Date is insufficient to repay the Loan Amount in full and the Linked Put Option or Linked Collar Option Automatically Exercises, so that NAB will sell the Underlying Securities for the Market Price on the Expiry Date on the investor's behalf and apply the Physical Settlement Amount (equal to the Exercise Price multiplied by the number of Options) in full satisfaction of the Loan Amount on the Maturity Date (under a Physical Settlement)
 - will repay the Loan Amount on the Expiry Date and retain the Underlying Securities, where the value of the Underlying Securities on the Expiry Date is insufficient to repay the Loan Amount in full and the Linked Put Option or Linked Collar Option Automatically Exercises, so that NAB will pay the investor the Cash Settlement Amount (equal to the Exercise Price less the Market Price on the Exercise Date, multiplied by the number of Options) on the Settlement Date (under a Cash Settlement), or
 - wishes for NAB to sell the Underlying Securities for the Market Price on the Expiry Date on the investor's behalf where the value of the Underlying Securities is above the Linked Loan Amount and the Linked Put Option or Linked Collar Option expires unexercised, and have any remaining sale proceeds, after repaying the Loan Amount and any other outstanding amounts relating to the PEL or the Linked Put Option or Linked Collar Option (including a Variable Premium Amount), credited to the investor on the Settlement Date.
47. Where the investor does not repay the Loan Amount on the Expiry Date or NAB does not approve the investor's request to refinance, NAB will sell the Underlying Securities on the investor's behalf and use the sale proceeds to repay the Loan Amount and any other outstanding amounts relating to the Linked Loan or the Linked Put Option or Linked Collar Option (including a Variable Premium Amount). Any excess remaining from the sale proceeds will be credited to the investor.

Assumptions

48. This Ruling is made on the basis of the following necessary assumptions:
- (a) The investor is an Australian resident for tax purposes.
 - (b) At all times during the scheme, where the Underlying Securities consist of shares, those shares satisfy the requirements of subparagraph 82KZME(5)(b)(ii) of the ITAA 1936.
 - (c) At all times during the scheme, where the Underlying Securities consist of units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936.

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- (d) At all times during the scheme, where the Underlying Securities consist of a stapled security, the stapled security comprises shares that satisfy the requirements of subparagraph 82KZME(5)(b)(ii) of the ITAA 1936 or units in a trust that satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936, as applicable.
- (e) The Underlying Securities are not ESS interests to which Subdivisions 83A-B or 83A-C (about employee share schemes) apply.
- (f) The investors will hold their interests in the Underlying Securities on capital account, are not traders in securities and are not treated for tax purposes as trading in securities, carrying on a business of investing in securities, or holding the Underlying Securities as trading stock or a revenue asset.
- (g) The investors will hold the Linked Put Option or Linked Collar Option on capital account, are not treated for tax purposes as trading in options or collars, carrying on a business of investing in options or collars, or holding the Linked Put Option or Linked Collar Option as trading stock or a revenue asset.
- (h) The Linked Put Option purchased by the investors will be a European Option.
- (i) The investors will not draw down on the PEL or Linked Loan for any purpose other than to fund the purchase price of Underlying Securities.
- (j) The dominant purpose of an investor in entering into the scheme is to derive an amount of receipts (income, gains and distributions) from the Underlying Securities acquired with the proceeds of the PEL or Linked Loan that exceeds the total expenses incurred in connection with the investment.
- (k) The investors have not made an election under subsection 230-455(7) to have Division 230 apply.
- (l) The scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation referred to in paragraph 11 of this Ruling.
- (m) All dealings by the investors and NAB under the scheme will be at arm's length.

Commissioner of Taxation

9 August 2023

 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.*

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

49. The interest paid on a borrowing used to acquire income-producing assets such as the Underlying Securities is generally treated as deductible under section 8-1 where it is expected that dividends, trust distributions 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.

50. 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.

51. Division 247 applies to the PEL or Linked Loan where the investor uses the PEL or Linked Loan to acquire a beneficial interest in the Underlying Securities and the investor is protected against the fall in the market value of those Underlying Securities.

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52. 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).

53. Where the investor has a PEL:

- (a) The cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in sub-subparagraph 10(a)(ii) of this Ruling.
- (b) Under step 1 of the method statement, the total amount incurred by the investor under or in respect of the PEL for the income year is the interest incurred on the PEL and any amounts that are in substance for capital protection for the income year.
- (c) Where the total amount incurred by the investor worked out under step 1 of the method statement is less than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, there is no amount reasonably attributable to the cost of capital protection. In these circumstances, the interest on the PEL will be fully deductible under section 8-1.
- (d) Where the total amount incurred by the investor worked out under step 1 of the method statement is greater than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, the balance is reasonably attributable to the cost of capital protection and is treated as if it were incurred for the put option (subsection 247-20(6)).
- (e) The investor's put option is a capital asset. Therefore, the amount reasonably attributable to the cost of capital protection is of a capital nature and not deductible under section 8-1.

54. Where the investor has a Linked Loan that is linked to a purchased Put Option or Collar:

- (a) The cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in sub-subparagraph 10(b)(i) of this Ruling.
- (b) Under step 1 of the method statement, the total amount incurred by the investor under or in respect of the Linked Loan for the income year is the interest incurred on the Linked Loan and any amounts that are in substance for capital protection (such as the Option Premium or Fixed Option Premium) for the income year.
- (c) Where the total amount incurred by the investor worked out under step 1 of the method statement is less than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, there is no amount reasonably attributable to the cost of capital protection. In these circumstances, the interest on the Linked Loan will be fully deductible under section 8-1.
- (d) Where the total amount incurred by the investor worked out under step 1 of the method statement is greater than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, the balance is reasonably attributable to the cost of capital protection. In calculating the additional amount (as per sub-subparagraph 10(b)(ii) of this Ruling), the amount reasonably attributable to the cost of capital protection

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will be reduced by the actual payment for a Linked Put Option or Linked Collar Option (the Option Premium or Fixed Option Premium, as applicable) in accordance with subsection 247-20(6). The additional amount, to the extent that it is greater than zero, constitutes a further cost of capital protection in addition to the Option Premium or Fixed Option Premium paid.

- (e) The investor's Linked Put Option or Linked Collar Option is a capital asset. Therefore, any Option Premium or Fixed Option Premium paid and the additional amount (if any) is capital in nature and not deductible under section 8-1.

55. Where an investor procures a PPEL to which NAB applies a single Interest Rate, the investment will be treated as one arrangement for the purposes of Division 247.

Section 51AAA of the ITAA 1936

56. By acquiring the Underlying Securities, it is contemplated that over the term of the PEL or Linked Loan an investor will derive assessable income by way of the receipt of dividend income or trust income, or both, as well as by way of capital gain. As interest incurred on the PEL or Linked Loan would have been deductible under section 8-1 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to an investor that enters into a Transaction under the Facility.

Section 82KL of the ITAA 1936

57. 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

58. 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 the carrying on of a business, whether the investor is a small or medium 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

59. 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

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- 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 2 previous income years, the aggregated turnover for each of those income years was less than \$10 million, or
- 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

60. The interest charged on the PEL or the Linked Loan that is deductible under section 8-1 is in relation to a prepayment of loan interest for a period that is 12 months or less. Paragraph 82KZL(2)(a) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principal is to be taken, for the purposes of Subdivision H 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

61. 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.

62. 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 Facility, including the financing, Underlying Security acquisition and Underlying Security disposal arrangements.

63. 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 PEL or Linked Loan from the operation of section 82KZMF of the ITAA 1936 as:

- the prepaid interest expenditure under the PEL or Linked Loan is incurred in respect of money borrowed to acquire Underlying Securities that are as described in subparagraphs 82KZME(5)(b)(ii) and (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 Facility are conducted at arm’s length.

64. Deductibility of the prepaid interest must therefore be considered under the prepayment rules contained in paragraphs 65 to 70 of this Ruling.

Status: **not legally binding**

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

65. 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 1936⁴, 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.

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

- expenditure is not excluded expenditure
- 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
- expenditure would otherwise be immediately deductible under section 8-1.

67. As the eligible service period in relation to the deductible interest payments under the PEL and Linked Loan is not more than 12 months and does not end after the last day of the year of income after the one in which the expenditure was incurred, section 82KZM of the ITAA 1936 will have no application to investors referred to in paragraph 65 of this Ruling. Such investors will be able to claim an immediate deduction for prepaid interest incurred under the PEL or Linked 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

68. 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 1936⁵, 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.

69. 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.

70. For these investors, the amount of prepaid interest incurred under the PEL or Linked Loan and allowable as a deduction under section 8-1 will be apportioned over the relevant interest payment period.

⁴ 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 59 of this Ruling) were instead a reference to \$50 million).

⁵ 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 59 of this Ruling) were instead a reference to \$50 million).

Status: **not legally binding**

Parts 3-1 and 3-3 – application of capital gains tax provisions to the Linked Put Option, Linked Collar Option and Underlying Securities

71. If an investor procures a PEL and the limited recourse provisions of the PEL are invoked at the Maturity Date, the investor will dispose of the Underlying Securities and CGT event A1 will arise for the investor in respect of the disposal (section 104-10). Under table item 2 of subsection 134-1(1), the investor's cost base and reduced cost base in the Underlying Securities for these purposes will include the amount reasonably attributable to the cost of capital protection (if any) as per sub-subparagraph 10(a)(ii) of this Ruling. Any capital gain or capital loss on exercise of the put option referred to in sub-subparagraph 10(a)(iii) of this Ruling will be disregarded (subsection 134-1(4)).

72. If an investor's Linked Put Option or Linked Collar Option is exercised and physically settled, the investor will dispose of the Underlying Securities and CGT event A1 will arise for the investor in respect of the disposal (section 104-10). Under table item 2 of subsection 134-1(1), the investor's cost base and reduced cost base in the Underlying Securities for these purposes will include the additional amount (if any) as per sub-subparagraphs 10(b)(ii) of this Ruling, plus any Option Premium or Fixed Option Premium paid. Any capital gain or capital loss on exercise of the Linked Put Option or Linked Collar Option will be disregarded (subsection 134-1(4)).

73. If an investor's Linked Put Option or Linked Collar Option is exercised and cash settled, CGT event C2 will arise for the investor in respect of the exercise of the Linked Put Option or Linked Collar Option (section 104-25). The cost base and reduced cost base of the Linked Put Option or Linked Collar Option will include the additional amount (if any) as per sub-subparagraph 10(b)(ii) of this Ruling, plus the Option Premium or Fixed Option Premium paid, as applicable (sections 110-25 and 110-55). No CGT event will occur in relation to the Underlying Securities.

74. Where an investor procures a PEL and the limited recourse provisions of the PEL are not invoked at the Maturity Date, CGT event C2 will arise for the investor in relation to the put option referred to in sub-subparagraph 10(a)(iii) of this Ruling (section 104-25). As the investor will not receive any capital proceeds in respect of the expiry of this put option, a capital loss will be made by the investor in this regard, equal to the investor's reduced cost base in the put option. Under section 110-55, the reduced cost base of this put option will include the amount reasonably attributable to the cost of capital protection (if any) as per sub-subparagraph 10(a)(ii) of this Ruling.

75. Where the Linked Put Option or Linked Collar Option expire unexercised, CGT event C2 will arise for the investor in relation to the Linked Put Option or Linked Collar Option at that time (section 104-25). As the investor will not receive any capital proceeds in respect of the expiry of the Linked Put Option or Linked Collar Option, a capital loss will be made by the investor in this regard, equal to the investor's reduced cost base in the Linked Put Option or Linked Collar Option. Under section 110-55, the reduced cost base of the Linked Put Option or Linked Collar Option will include:

- the additional amount (if any) as per sub-subparagraph 10(b)(ii) of this Ruling, plus the Option Premium or Fixed Option Premium paid (as applicable), and
- in the case of the Linked Collar Option only, any Variable Premium Amount paid by the investor.

Status: **not legally binding**

76. Division 115 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5, any capital gain realised by an investor on the sale of the Underlying Securities or exercise of the Linked Put Option or Linked Collar Option under a Cash Settlement will be treated as a discount capital gain where the investor is an individual or a trust and has held the Underlying Securities, Linked Put Option or Linked Collar Option for more than 12 months (excluding the days of acquisition and disposal).

Division 230 – taxation of financial arrangements

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

- an individual
- 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
- an authorised deposit-taking institution, a securitisation vehicle or other financial sector entity with an aggregated turnover of less than \$20 million, or
- another entity with an aggregated turnover of less than \$100 million, financial assets of less than \$100 million and assets of less than \$300 million.

Section 25-25 – Loan Establishment Fee

78. Any Loan Establishment Fee incurred by an investor upon successful application for the PEL or Linked 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 PEL or Linked Loan.

Status: **not legally binding**

References

Related Rulings/Determinations:

TR 95/33

Legislative references:

- ITAA 1936 51AAA
 - ITAA 1936 82KL
 - ITAA 1936 Pt III Div 3 Subdiv H
 - ITAA 1936 82KZL(1)
 - ITAA 1936 82KZL(2)(a)
 - ITAA 1936 82KZM
 - ITAA 1936 82KZM(1A)
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 - ITAA 1997 104-25(1)(c)
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 - ITAA 1997 104-25(3)
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 - ITAA 1997 Div 247
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 - ITAA 1997 247-20(4)
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