TR 2016/2EC - Compendium

Ruling Compendium – TR 2016/2

This is a compendium of responses to the issues raised by external parties to draft TR 2015/D3 – *Income tax: taxation of financial arrangements – how section 230-120 of the Income Tax Assessment Act 1997 applies to the taxation of swaps under the accrual/realisation rules in Subdivision 230-B of that Act*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	It would be useful for the ruling to comment on whether section 230-120 applies to a typical forward exchange contract. We do not believe the notional construct of section 230-120 would apply.	Industry has been contacted to obtain a sample contract and a realistic example with a view to including commentary in an updated version of the Ruling. The issue of the final ruling will not be delayed but an addendum or other ATO guidance can be considered once the requested material has been received.
2	It would be useful if the ruling commented on credit default options as well as credit default swaps. It is useful to clarify that the upfront fee is not considered an option premium.	The treatment of credit default options is beyond the scope of the ruling. As noted in the submission, the Explanatory Memorandum ('EM') to the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008 (at Example 3.1) takes the approach that the gain or loss on a typical option is calculated by offsetting the cost or proceeds represented by the premium against the net amounts, if any, received or paid from disposal or exercise of that option.
3	It would be helpful if the ruling could provide an example of something that would be regarded as a 'thing' for the purpose of section 230-120. For example, if there is a service type fee payable under a swap that is neither related to either notional leg, would the service fee be regarded as an 'other thing', or would the service type fee need to be bifurcated to each leg under section	The Ruling sets out what a 'thing' is for the purpose of section 230-120: 'A 'thing' is anything else of which the notional construct consists which is not a leg (subparagraph 230-120(1)(a)(iii)). In particular, anything not relevantly related to the notional principal will not form part of a leg.' Industry has been contacted to provide a realistically priced example of a thing which actually exists in the marketplace. The issue of the final ruling will not be delayed but an addendum or other ATO guidance can be

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	230-65 (that is, on the assumption that each leg were a separate financial arrangement). Furthermore, if the service type fee is regarded as an 'other thing', how would the fee be brought to account? For example, it is possible for this fee to be prepaid (upfront on establishment) or for the fee to be paid over the life of the arrangement (or a combination of both). Would the provision require: • the application of the realisation method under section 230-180 on the payment / liability to pay any service type fee; or • would an accruals basis of taxation apply to the fee based on a notional principal rule contained in subsection 230-135(6A); or • is there another method that would be used to accrue the fee under subparagraph 230-120(3)(c)(ii), given that the provision only requires taxpayers to have regard to a 'manner which properly reflects the way in which the financial benefits in respect of that thing are calculated'. • As it is unclear what would be classified as a 'thing' and how the special rule in subparagraph	considered once the requested material has been received. As to how to bring such a 'thing' to account, the legislation provides a very broadly worded principle as to how to bring a 'thing' to account, if one exists: ***(c)*** *in working out a gain or loss from a thing for the purposes of subparagraph (b)(i), and, if the accruals method applies to the gain or loss, how it is to be spread and allocated:* ***(ii)*** *if the thing is not a leg -* ***take into account an amount relevant to the thing at a time and in a manner that properly reflects the way in which the financial benefits in respect of that thing are calculated****.*

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	230-130(3)(c)(ii) applies to 'other things', it would be useful if the ruling discussed this aspect to clarify its operation	
4	Example 1 should mention the running balancing adjustment in the overview to help readers understand what is estimated will be adjusted later.	Agreed. A new sentence is added in the first dot point of paragraph 58 as a signpost.
5	Add a signpost to the subsequent need to make a running balancing adjustment to: (a) as a footnote to para 64 at the end of the first sentence after the words 'is applied'	Agreed.
6	The reference at the second sentence of paragraph 68 to 'running balancing adjustment under section 230-170' might need to refer instead to section 230-175.	Agreed.
7	Example 1 should mention the straight line accruals as a method acceptable under paragraph 230-135(2)(b).	The draft Ruling states at paragraph 63 that it is acceptable to use a method whose results approximate those obtained using the compounding accruals. The final Ruling is changed to note that the Commissioner would accept straight line accruals where the regularity of payments is at least annual, the notional principal is the same and does not change, there are no lumpy payments, and a consistent approach is taken in accordance with section 230-80: see case study 5 and case study 6 EM. The Example 1 swap would not qualify, as having a lumpy payment of $1,833.
8	It would be useful to see some guidance as to more complex variations of swaps arrangements. For example, a cross currency swap with a mark-to-market Condition can be dealt with in the final	Industry has been contacted to obtain a sample contract and a realistic example with a view to including commentary in an updated version of the Ruling. The issue of the final ruling will not be delayed but an addendum or other ATO guidance can be considered once the requested material has

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	Ruling.	been received.
9	Example 3: Total Return Swap: accrual of dividend-like payments The requirement to apply the accruals method to dividend-like payments under a total return swap appears to be unaligned with commercial practice and increases compliance costs. Such payments can be assessed under a realisation method (on declaration or on payment). We suggest that dividend equivalent payments be treated as assessable on a realization basis upon declaration. This will permit several taxpayers to follow their accounting entries in recognizing dividend equivalent payments upon declaration and will ensure that the ATO is not prejudiced from a timing perspective in the recognition of any assessable gains on these payments. Alternatively, should the Commissioner prefer to recognize dividend equivalent payments on realization basis when paid, in order to align with the requirements for the taxation of real dividends under section 44 of the *Income Tax Assessment Act 1936*, we would also consider this an acceptable second alternative.	The law is clear that once a dividend is declared, a dividend equivalent payment under a swap of a particular amount will be paid. Prior to declaration, such an amount is uncertain. On declaration, it becomes sufficiently certain, but is not payable, and so the provisions require it to be accrued.