



# ***PR 2002/109 - Income tax: tax consequences of investing in Macquarie Hot Instalments IMD Series - cash applicants and on-market purchasers***

 This cover sheet is provided for information only. It does not form part of *PR 2002/109 - Income tax: tax consequences of investing in Macquarie Hot Instalments IMD Series - cash applicants and on-market purchasers*

 This document has changed over time. This is a consolidated version of the ruling which was published on *2 July 2003*



## Product Ruling

### Income tax: tax consequences of investing in Macquarie Hot Instalments IMD Series – cash applicants and on-market purchasers

Contents	Para
What this Product Ruling is about	1
Date of effect	8
Withdrawal	10
Arrangement	11
Ruling	18
Assumptions	19
Explanations	20
Detailed contents list	54

Participants may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

#### *Preamble*

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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

#### **No guarantee of commercial success**

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give 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. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend 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 below in the **Ruling** part of this document are available **provided that** the arrangement is carried out in accordance with the information we have been given and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

## **Terms of Use of this Product Ruling**

---

This Product Ruling has been given on the basis that the person(s) 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.

## **What this Product Ruling is about**

---

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person who takes part in the arrangement to which this Ruling relates. In this Ruling the arrangement is the acquisition of a Macquarie Hot Instalment Warrant IMD Series ('Macquarie Hot Instalments') which provides an investment in shares that are listed for quotation on the Australian Stock Exchange ('ASX'), and/or units in a widely held listed trust and a put option using a loan made by Macquarie Bank Limited ('Macquarie').

### **Tax law(s)**

2. The tax laws dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - section 8-1 (ITAA 1997);
  - section 20-20 (ITAA 1997);
  - section 25-25 (ITAA 1997);
  - section 104-10 (ITAA 1997);
  - subsection 104-10(7) (ITAA 1997);
  - section 109-5 (ITAA 1997);
  - section 110-25 (ITAA 1997);
  - subsection 110-45(3) (ITAA 1997);
  - section 112-35 (ITAA 1997);
  - section 115-5 (ITAA 1997);
  - section 116-20 (ITAA 1997);
  - section 116-55 (ITAA 1997);
  - section 134-1 (ITAA 1997);
  - section 960-335 (ITAA 1997);
  - section 960-340 (ITAA 1997);
  - section 51AAA of the *Income Tax Assessment Act 1936* ('ITAA 1936');

- section 82KL (ITAA 1936);
- section 82KZM (ITAA 1936);
- section 82KZMA (ITAA 1936);
- section 82KZMB (ITAA 1936);
- section 82KZMC (ITAA 1936);
- section 82KZMD (ITAA 1936);
- section 82KZME (ITAA 1936);
- section 82KZMF (ITAA 1936);
- section 97 (ITAA 1936); and
- Part IVA (ITAA 1936).

### **Class of persons**

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below, through Cash Applications or on-market purchases, on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed and of deriving assessable income from their involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Investors'.

4. This Ruling does not apply to Investors who are Shareholder Applicants.

### **Qualifications**

5. The Commissioner rules on the precise arrangement identified in the Ruling.

6. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

7. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the

Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra  
ACT 2601.

## Date of effect

---

8. This Ruling applies prospectively from 28 August 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

9. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

---

10. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

## Arrangement

---

11. The arrangement that is the subject of this Ruling is described below. This description incorporates the following documents:

- application for a Product Ruling dated 16 July 2002 received from Allens Arthur Robinson on behalf of Macquarie Bank Limited;
- Macquarie Instalments Trust Deed dated 28 February 2001;

- Offering Circular for Macquarie Hot Instalments dated 17 April 2002;
- Taxation Supplement; and
- Draft Loan Agreement.

12. Macquarie Hot Instalments are offered over shares and units in certain widely held listed trusts. In this Ruling the underlying shares and units are referred to as the 'Underlying Parcel'. Any reference to shares and shareholders includes units and unitholders.

13. Macquarie Hot Instalments are a highly geared longer term product that allows Investors to gain exposure to share price movements and dividends/trust income without paying the full price of the share. The gearing level is maintained within a range of approximately 70-95% of the underlying share price.

14. The details of the aspects of the arrangement subject to this Ruling are summarised as follows:

- (a) Macquarie Hot Instalments provide a leveraged investment in the Underlying Parcel using a Loan made by Macquarie. There are 2 main methods by which Macquarie Hot Instalments are created:

(i) Cash Applications:

The Investor pays the varying First Payment. Macquarie lends the Completion Payment amount to the Investor and takes a security interest over the Underlying Parcel. Proceeds of the Loan and the First Payment from the Investor are applied toward:

- prepayment of interest to Macquarie;
- payment of borrowing fees to Macquarie; and
- the purchase of the Underlying Parcel.

Macquarie buys the Underlying Parcel in the name of the Security Trustee. The Macquarie Hot Instalment is issued in the name of the Investor; or

(ii) Shareholder Applications:

The Investor transfers the legal title of an existing shareholding to the Security Trustee. Macquarie lends the Completion Payment amount to the Investor and takes a security interest over the Underlying Parcel. The proceeds of the Loan are applied toward:

- prepayment of interest to Macquarie;
- payment of borrowing fees to Macquarie; and
- payment of a cashback amount to the Investor to be used for investment purposes or, if directed, to purchase additional Macquarie Hot Instalments.

The Macquarie Hot Instalment is issued in the name of the Investor;

- (b) Investors can acquire Macquarie Hot Instalments either as an Applicant as set out in (a) above or as an on-market purchaser;
- (c) Investors can obtain the Underlying Parcel at any time before the Maturity Date by making the Completion Payment;
- (d) the Completion Payment is equal to the Loan Amount on the date the Completion Payment is made;
- (e) the Loan is made on a limited recourse basis, secured by a mortgage over the Underlying Parcel which will be held by the Security Trustee as nominee for the Investor;
- (f) in the case of a Cash Applicant or a Shareholder Applicant, the borrowing fee will comprise two components, a fee for the grant of the Holder's Put Option and an amount which is paid for acquiring the Loan from Macquarie;
- (g) interest and borrowing fees are also payable at each Annual Reset Date. The borrowing fee will comprise two components, a fee for the grant of the Holder's Put Option and an amount which is paid for resetting the Loan Amount by Macquarie;
- (h) the Loan Amount is fixed until the first Annual Reset Date. Thereafter there is a yearly review of the Loan Amount. Where the value of the Underlying Parcel has increased Investors can either receive cash payments or additional Macquarie Hot Instalments. Where the value of the Underlying Parcel has decreased (or has not increased by much) the Loan may be reduced and Investors may be required to make a payment to cover the decrease plus the Interest Amount and Borrowing Fees or risk some or all of their Macquarie Hot Instalments terminating;

- (i) at Maturity, the Investor has 4 options:
  - (i) pay the Completion Payment:

The Loan is repaid, the security interest is extinguished and the shares or units are delivered to a holding in the Investor's name;
  - (ii) exercise the Holder's Put Option:

The shares or units are purchased by Macquarie at the higher of the Completion Payment or the market price and the proceeds are applied to repayment of the Loan with any residual paid to the Investor;
  - (iii) roll over:

A roll over is equivalent to the Investor completing the expiring series by making the Completion Payment and then investing in the new series by way of a Shareholder Application. Under the roll over, the Underlying Parcel is not sold rather, the expiring warrant is cancelled and the Investor is allotted a Macquarie Hot Instalment in the new series; or
  - (iv) do nothing:

At Maturity if the Completion Payment is not made, and the Holder's Put Option is not exercised, the Underlying Parcel will be sold and any surplus from net proceeds after repayment of the Loan and costs will be paid to the Investor. If the sale proceeds are insufficient to repay the Loan, Macquarie has no recourse against the Investor to recover the shortfall;
- (j) at any time during the life of the Macquarie Hot Instalments, the Investor has the option to make the Completion Payment, roll over into a new series of instalment warrants or sell their instalments on the ASX; and
- (k) where the Macquarie Hot Instalments are purchased on the ASX, the on-market purchaser acquires the Macquarie Hot Instalments on the same terms and conditions under which they were originally issued. In particular, the on-market purchaser will be offered and will accept a loan from Macquarie upon the transfer of the Macquarie Hot Instalments from the previous owner to the on-market purchaser. The loan provided

by Macquarie will be equal to the previous owner's loan and will be applied to discharge the previous owner's loan, refund part of the interest prepaid by the previous owner and to prepay the Interest Amount on the newly acquired loan.

## The Participants

15. Macquarie is the Issuer of the Macquarie Hot Instalments. Macquarie is also the provider of the Loans to Investors to fund the acquisition of the Underlying Parcel.
16. Belike Nominees Pty Ltd holds the legal title to the Underlying Parcel as nominee for each Investor.
17. The Investors may be individuals, companies, trusts or superannuation funds.

## Ruling

---

18. Subject to the assumptions listed in paragraph 19 of this Ruling:
  - (a) section 8-1 of the ITAA 1997 will apply to allow an Investor a deduction for the interest charged under the Loan Agreement;
  - (b) section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction for the interest allowable under section 8-1 of the ITAA 1997;
  - (c) section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest allowable under section 8-1 of the ITAA 1997;
  - (d) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the interest charge incurred under the Macquarie Hot Instalment;
  - (e) section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility of any part of the Macquarie Hot Instalment interest charge allowable under section 8-1 of the ITAA 1997 where at least one of the following applies for the year of income:
    - the Investor is an STS taxpayer; or
    - the Investor is an individual who does not incur the interest charge in carrying on a business;

- (f) sections 82KZMA, 82KZMB, 82KZMC and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the Macquarie Hot Instalment interest charge that is deductible to an Investor (other than an STS taxpayer for the year of income) who is a taxpayer that is not an individual and does not carry on a business;
- (g) the part of the borrowing fee which is applicable to the purchase of the Put Option forms the cost base to the Investor of the Underlying Parcel under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised;
- (h) the part of the borrowing fee which is applicable to the purchase of the Put Option forms the cost base to the Investor of the Holder's Put Option under section 110-25 of the ITAA 1997 if the Holders' Put Option is not exercised. If the sale proceeds are insufficient to repay the Loan, Macquarie has no recourse against the Investor to recover the shortfall. In this circumstance the Investor will need to reduce the cost base of the shares by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997;
- (i) for on-market purchasers the cost base of the Put Option is calculated as follows:
- if the market value of the share or unit at the time of purchase is greater than the Completion Payment (the Loan Amount) the cost base of the Put Option is the total consideration as determined by section 110-25 and section 112-35 of the ITAA 1997 (the price of the Macquarie Hot Instalment plus the Completion Payment) less the sum of the market value of the share or unit and the interest prepaid on the newly acquired loan;
  - if the market value of the share or unit at the time of purchase is less than the Completion Payment the cost base of the Put Option is the total consideration as determined by section 110-25 and section 112-35 of the ITAA 1997 (the price of the Macquarie Hot Instalment plus the Completion Payment) less the sum of the Completion Payment and the interest prepaid on the newly acquired loan;
- (j) the portion of the Borrowing fee that is paid for acquiring the Loan from Macquarie or resetting the

- Loan Amount by Macquarie will be deductible to the Investors under section 25-25 of the ITAA 1997;
- (k) for capital gains tax purposes, including for the purposes of the CGT discount, the date of acquisition of the Underlying Parcel, for Investors who acquire Macquarie Hot Instalments as Cash Applicants or as on market purchasers, is the date on which Cash Applicants and on-market purchasers acquire the related Macquarie Hot Instalment;
  - (l) no CGT event arises when the legal title to the Underlying Parcel is transferred by the Security Trustee to the Investor;
  - (m) a CGT event will arise under section 104-10 of the ITAA 1997 to the Investor where the Completion Payment is not made and the Macquarie Hot Instalment is sold;
  - (n) only the Investors in Macquarie Hot Instalments (and not the Security Trustee) are assessable on all of the income derived from the Underlying Parcel while the Underlying Parcel is the subject of the Separate Trust;
  - (o) on the sale of a Macquarie Hot Instalment on the ASX, the refund of any prepaid interest will be assessable under section 6-5 of the ITAA 1997 or alternatively it will be an assessable recoupment under section 20-20 of the ITAA 1997;
  - (p) on the sale of a Macquarie Hot Instalment on the ASX, the vendor's capital proceeds under section 116-20 of the ITAA 1997 will include the amount of the Completion Payment (Loan Amount) applied to discharge the Loan; and
  - (q) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not be applied to deny deductibility of the interest incurred by the Investor in respect of borrowings used to fund the purchase of the Underlying Parcel.

## **Assumptions**

---

19. This Ruling is made on the basis of the following assumptions:
- (a) all of the Investors are Australian Residents;
  - (b) the Investors are not traders in investments and are not treated for taxation purposes as either trading in the

Underlying Parcel or carrying on a business of investing in the Underlying Parcel. In particular, the Underlying Parcel is not trading stock or a revenue asset to the Investor;

- (c) in respect of any interest charges to be paid in advance under the Loan Agreement, these may be prepaid, but only in relation to a loan interest payment period of 12 months or less that ends on or before the last day of the income year following the expenditure year;
- (d) the dominant purpose of an Investor in entering the arrangement is to derive assessable income from their investment in the Macquarie Hot Instalments;
- (e) the arrangement will be executed in the manner described in the 'Arrangement' section of this Ruling;
- (f) all dealings by the Investors and Macquarie will be at arm's length;
- (g) the Underlying Parcel will not be the subject of any securities lending arrangement; and
- (h) where the Underlying Parcel is a unit in a trust, the trust is a trust that has at least 300 beneficiaries and is a widely held unit trust as defined in section 272-105 in Schedule 2F of the ITAA 1936.

## **Explanations**

---

### ***Section 8-1 of the ITAA 1997***

20. The cost (or interest paid) of a borrowing used to acquire income producing assets such as shares or units in a trust 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 (see Taxation Ruling TR 95/33).

21. The ATO is of the view that no part of the interest charged on an investment in Macquarie Hot Instalments is a capital protection fee. The capital protection is provided by the Put Option. Therefore, Investors will not be denied a deduction for any part of the interest under section 8-1, provided that the other requirements of that section are satisfied. This is the case regardless of whether the Investor acquired the Macquarie Hot Instalment by application or by purchase on the ASX.

***Borrowing fee***

22. Part of the borrowing fee is a payment for the purchase of the Put Option and the balance represents a payment for acquiring the Loan from Macquarie or for resetting the Loan Amount by Macquarie. This payment is deductible under section 25-25 of the ITAA 1997. The ATO is of the view that the part of the borrowing fee which is applicable to the purchase of the Holder's Put Option is not deductible but forms the cost base of the Holder's Put Option if that option is not exercised and forms part of the cost base of the Underlying Parcel if the option is exercised.

23. The payment of that part of the borrowing fee which is applicable to the Put Option ensures that the borrower is protected from liability to repay the principal if the market value of the shares or units falls below their original purchase price. In effect, the Put Option ensures that Macquarie will acquire the shares or units in full satisfaction of the Loan Amount if the shares or units have fallen in value below the amount borrowed. Accordingly, the payment for the Put Option is a capital protection fee. The payment is capital in nature, being paid to acquire an asset, namely, the Put Option.

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

24. By investing in Macquarie Hot Instalments, it is contemplated that an Investor will derive assessable income by the receipt of dividend income and capital gains. Accordingly, the interest would have been deductible under section 8-1 of the ITAA 1997 irrespective of whether the capital gain is included in assessable income. Accordingly, section 51AAA has no application to an Investor in Macquarie Hot Instalments.

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

25. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient additional benefits will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

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

26. This Subdivision 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 an 'STS taxpayer', whether the Investor is an individual and whether the expenditure qualifies for transitional treatment. This Subdivision does not apply to "excluded expenditure" which is defined in subsection 82KZL(1) to include amounts of less than \$1,000.

*Subdivision 328-F and Subdivision 328-G of the ITAA 1997 – STS taxpayer*

27. An Investor will be an STS taxpayer for an income year if the Investor is eligible to be an STS taxpayer for that year and the Investor notifies the Commissioner of the choice to become such a taxpayer for that year.

28. An Investor will be eligible to be an STS taxpayer for an income year if the Investor carries on a business and the STS average turnover of the business and related business for that year is less than \$1 million and the business and related businesses have depreciating assets with a total adjustable value below \$3 million at the end of that year.

*The eligible service period for the purposes of Subdivision H of Division 3 of Part III of the ITAA 1936*

29. The interest allowable under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is not more than 12 months. Paragraph 82KZL(2)(a) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principal is to be taken, for the purposes of Subdivision H, to be expenditure incurred under an agreement in return for the doing of a thing under the agreement for the period to which the interest payment 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, which is 12 months, and not to the period of the loan, which is 4 years for Macquarie Hot Instalments.

*Sections 82KZME and 82KZMF of the ITAA 1936: prepaid expenditure and 'tax shelter' arrangements*

30. The rules in sections 82KZME and 82KZMF apply, subject to the exceptions in section 82KZME, where expenditure is incurred in relation to a 'tax shelter' arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

31. For the purposes of section 82KZME, '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 Macquarie Hot Instalments, including the financing, share or unit purchase, shareholding or unitholding and disposal arrangements.

32. Under the arrangement, when the purchaser acquires Macquarie Hot Instalments, they acquire beneficial ownership of the Underlying Parcel of shares or units.

33. Exception 1, as contained in subsection 82KZME(5), applies to exclude the interest incurred on borrowings under the Macquarie Hot Instalments from the operation of section 82KZMF, as:

- the prepaid interest expenditure under the Macquarie Hot Instalments is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX or units in a trust that has at least 300 beneficiaries and is a widely held unit trust as defined in section 272-105 in Schedule 2F;
- the Investor can reasonably be expected to obtain dividends or trust income 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 Macquarie Hot Instalments are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 34 to 40 below.

*Section 82KZM of the ITAA 1936: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure*

34. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure incurred by a taxpayer that is either:

- an STS taxpayer for the year of income; or
- a taxpayer that is an individual and the expenditure is not incurred in carrying on a business.

35. The expenditure must not be excluded expenditure and must be incurred otherwise than in carrying on a business. Section 82KZM applies if 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 of the ITAA 1997.

36. As the eligible service period in relation to the deductible interest for Macquarie Hot Instalments 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 will have no application to Investors who are STS taxpayers for the year of income, or to Investors who are individuals and the expenditure is not incurred in carrying on a business. Investors who satisfy these tests will be able to claim an immediate deduction for the interest incurred.

*Sections 82KZMA - 82KZMD of the ITAA 1936: prepaid non-business expenditure incurred by non-individual and non-STs taxpayers*

37. Sections 82KZMA, 82KZMB, 82KZMC and (in respect of income years after the year of income including 21 September 2002) section 82KZMD set the amount and timing of deductions for expenditure for an Investor (other than an STS taxpayer for the year of income) who is a taxpayer that is not an individual and does not incur the expenditure in carrying on a business.

38. 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.

39. For these taxpayers, the deduction for prepaid interest on the Macquarie Hot Instalment will be apportioned over the relevant interest payment period, subject to the transitional provisions in section 82KZMB (applying to expenditure incurred before or during the Investor's year of income that includes 21 September 2002).

40. Section 82KZMD will not apply to an Investor in respect of interest payments on the borrowings under the Macquarie Hot Instalment incurred before or during the Investor's year of income that includes 21 September 2002 as the eligible service period to which the interest payments relate will end not more than 13 months after the expenditure is incurred.

*Section 6-5 and/or section 20-20 of the ITAA 1997*

41. On the sale of a Macquarie Hot Instalment by the Investor on the ASX prior to Maturity, the refund of any prepaid interest to the Investor will be assessable under section 6-5 or alternatively it will be an assessable recoupment under section 20-20.

*Section 109-5 of the ITAA 1997: time of acquisition*

42. Section 109-5 applies to Cash Applicants and on-market purchasers to treat them as having acquired the Underlying Parcel at

the same time that the Macquarie Hot Instalment was acquired, since this is the time from which the Cash Applicants and on-market purchasers obtain the beneficial ownership of the Underlying Parcel.

***Section 115-5 of the ITAA 1997: CGT discount***

43. For Cash Applicants and on-market purchasers, in accordance with section 115-5, the 12 month period for the purposes of the CGT discount will run from the date of acquisition of the Macquarie Instalment.

***Subsection 104-10(7) of the ITAA 1997: time of disposal***

44. When the Completion Payment is made, no CGT event will arise in respect of the transfer of the legal title to the Underlying Parcel from the Security Trustee to the Investor by virtue of subsection 104-10(7).

***Section 104-10 of the ITAA 1997: CGT event A1***

45. A CGT event will arise to the Investor if the Investor does not make the Completion Payment and the Macquarie Hot Instalment is sold to Macquarie or to a third party.

***Sections 116-20 and 116-55 of the ITAA 1997***

46. On the sale of a Macquarie Hot Instalment on the ASX, the vendor's capital proceeds under section 116-20 of the ITAA 1997 will include the amount of the Completion Payment (Loan Amount) applied to discharge the Loan.

***Section 97 of the ITAA 1936***

47. The Investors are presently entitled to all of the income derived from the Underlying Parcel. Therefore, section 97 will apply to assess the Investors on the income derived from the Underlying Parcel. The Security Trustee will not be subject to tax on this income.

***Section 110-25 and subsection 110-45(3) of the ITAA 1997***

***Cost Base of Put Option***

48. The part of the borrowing fee which is applicable to the purchase of the Holder's Put Option forms the cost base of the Put Option under section 110-25.

49. The part of the borrowing fee which is applicable to the purchase of the Put Option forms the cost base to the Investor of the Underlying Parcel under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised.

50. The part of the borrowing fee which is applicable to the purchase of the Put Option forms the cost base to the Investor of the Holder's Put Option under section 110-25 of the ITAA 1997 if the Holders' Put Option is not exercised. If the sale proceeds are insufficient to repay the Loan, Macquarie has no recourse against the Investor to recover the shortfall. In this circumstance the Investor will need to reduce the cost base of the shares or units by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997.

*Cost Base of Put Option for On-Market Purchasers*

51. If the market value of the share or unit at the time of purchase is greater than the Completion Payment (the Loan Amount) the cost base of the Put Option is the total consideration as determined by section 110-25 and section 112-35 of the ITAA 1997 (the price of the Macquarie Hot Instalment plus the Completion Payment) less the sum of the market value of the share or unit and the interest prepaid on the newly acquired loan.

52. If the market value of the share at the time of the purchase is less than the Completion Payment the cost base of the Put Option is the total consideration as determined by section 110-25 and section 112-35 of the ITAA 1997 (the price of the Macquarie Hot Instalment plus the Completion Payment) less the sum of the Completion Payment and the interest prepaid on the newly acquired loan.

*Part IVA of the ITAA 1936*

53. Provided that the arrangement is entered into and carried out as disclosed (see the **Arrangement** part of this Ruling), it is accepted that the arrangement is a normal commercial transaction and Part IVA will not apply.

## **Detailed contents list**

---

54. Below is a detailed table of contents list for this Product Ruling:

	<b>Paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>

Tax law(s)	2
Class of persons	3
Qualifications	5
<b>Date of effect</b>	<b>8</b>
<b>Withdrawal</b>	<b>10</b>
<b>Arrangement</b>	<b>11</b>
The Participants	15
<b>Ruling</b>	<b>18</b>
<b>Assumptions</b>	<b>19</b>
<b>Explanations</b>	<b>20</b>
<i>Section 8-1 of the ITAA 1997</i>	20
<i>Borrowing fee</i>	22
<i>Section 51AAA of the ITAA 1936</i>	24
<i>Section 82KL of the ITAA 1936</i>	25
<i>Subdivision H of Division 3 of Part III of the ITAA 1936</i>	26
<i>Subdivision 328-F and Subdivision 328-G of the ITAA 1997 – STS taxpayer</i>	27
<i>The eligible service period for the purposes of Subdivision H of Division 3 of Part III of the ITAA 1936</i>	29
<i>Sections 82KZME and 82KZMF of the ITAA 1936: prepaid expenditure and ‘tax shelter’ arrangements</i>	30
<i>Section 82KZM of the ITAA 1936: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure</i>	34
<i>Sections 82KZMA – 82KZMD of the ITAA 1936: prepaid non-business expenditure incurred by non-individual and non-STs taxpayers</i>	37
<i>Section 6-5 and/or section 20-20 of the ITAA 1997</i>	41
<i>Section 109-5 of the ITAA 1997: time of acquisition</i>	42
<i>Section 115-5 of the ITAA 1997: CGT discount</i>	43
<i>Subsection 104-10(7) of the ITAA 1997: time of disposal</i>	44
<i>Section 104-10 of the ITAA 1997: CGT event A1</i>	45
<i>Sections 116-20 and 116-55 of the ITAA 1997</i>	46
<i>Section 97 of the ITAA 1936</i>	47
<i>Section 110-25 and subsection 110-45(3) of the ITAA 1997</i>	48

<i>Cost Base of Put Option</i>	48
<i>Cost Base of Put Option for On-Market Purchasers</i>	51
<i>Part IVA of the ITAA 1936</i>	53
<b>Detailed contents list</b>	<b>54</b>

**Commissioner of Taxation**

28 August 2002

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*TR 92/1; TR 92/20; TR 95/33,  
TR 97/16; TD 93/34; PR 1999/95*Subject references:*

- financial products
- interest expenses
- prepaid expenses
- product rulings
- public rulings
- small business taxpayer
- taxation administration
- tax avoidance

*Legislative references:*

- TAA 1953 Part IVAAA
- ITAA 1936 51AAA
- ITAA 1936 82KL
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMB
- ITAA 1936 82KZMC

- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(5)
- ITAA 1936 82KZMF
- ITAA 1936 Subdiv H, Div 3,  
Pt III
- ITAA 1936 97
- ITAA 1936 Pt IVA
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 20-20
- ITAA 1997 104-10
- ITAA 1997 104-10(7)
- ITAA 1997 109-5
- ITAA 1997 110-25
- ITAA 1997 110-45(3)
- ITAA 1997 112-35
- ITAA 1997 115-5
- ITAA 1997 116-20
- ITAA 1997 116-55
- ITAA 1997 134-1
- ITAA 1997 Subdiv 328-F
- ITAA 1997 Subdiv 328-G
- ITAA 1997 960-335
- ITAA 1997 960-340

## ATO references:

NO: 2002/007989

ISSN: 1441 1172