


PR 2003/68 - Income tax: tax consequences of investing in Next Financial Instalments Series NF 300

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 This document has changed over time. This is a consolidated version of the ruling which was published on *17 December 2003*



Product Ruling

Income tax: tax consequences of investing in Next Financial Instalments Series NF 300

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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.

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 the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for 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. Participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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 borrowing of monies from Next Financial Pty Ltd ('Next Financial') in connection with an investment by the taxpayer in Next Financial Instalments NF 300 Series ('NF 300 Instalments') which provides an investment in shares listed for quotation on the Australian Stock Exchange ('ASX') and/or units in widely held listed trusts and a put option ('Put Option').
2. [Deleted]

Tax law(s)

3. The tax laws dealt with in this Ruling are:
 - section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 25-25 (ITAA 1997);
 - section 104-10 (ITAA 1997);
 - section 104-25 (ITAA 1997);
 - section 109-5 (ITAA 1997);
 - section 110-25 (ITAA 1997);
 - section 110-45 (ITAA 1997)
 - section 115-5 (ITAA 1997);
 - section 134-1 (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 82KZMD (ITAA 1936);
 - section 82KZME (ITAA 1936)

- section 82KZMF (ITAA 1936);
- section 97 (ITAA 1936); and
- Part IVA (ITAA 1936).

Class of Persons

4. The class of persons to whom this Ruling applies is those who enter into the arrangement described on or after the date this Ruling is made with the purpose of staying in the arrangement until it is completed and of deriving assessable income from their investment in NF 300 Instalments as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Investors'.

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.

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Date of effect

8. This Ruling applies prospectively from 19 November 2003, 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).

Note: The Addendum to this Ruling that issued on 17 December 2003 applies on and from 17 December 2003.

Withdrawal

10. This Product Ruling is withdrawn and ceases to have effect after 30 June 2007. 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. The description incorporates the following documents:

- Application for Product Ruling dated 24 January 2003, and correspondence dated 5 March 2003, 12 March 2003 and 27 March 2003 from Blake Dawson Waldron on behalf of Next Financial;
- Product Disclosure Statement for the Next Financial Instalments (the 'PDS') prepared and issued by Next Financial, draft dated 11 November 2003;
- Rate Sheet (the 'Rate Sheet') prepared and issued by Next Financial, draft dated 15 October 2003;
- Confirmation of Intention to Transact ('Intention'), draft dated 26 September 2003;

- Next Financial Instalment Confirmation issued by Next Financial ('Confirmation'), draft dated 15 October 2003;
- Next Financial Instalments Deed (the 'Instalment Deed') executed by Next Financial (as Issuer) and Next Financial Nominees Pty Ltd (as Security Trustee), dated 9 May 2003;
- Next Financial Instalments Nominee Deed (the 'Nominee Deed') to be executed by Next Financial Nominees Pty Ltd ('Nominees'), draft dated 3 November 2003 (refer page 65 of the PDS); and
- Next Financial Instalments Loan Agreement (the 'Loan Agreement'), draft dated 3 November 2003 (refer page 57 of the PDS).

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

12. On acceptance of an Investor's Intention, the Investor will enter into the Loan Agreement with Next Financial, appoint Nominees to act as its nominee on the terms of the Nominee Deed and will accept the NF 300 Instalments on the terms and conditions set out in the Instalment Deed.

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

- (a) NF 300 Instalments involve the Investor acquiring shares in ASX listed companies and/or units in a trust that has at least 300 beneficiaries and is a widely held trust as defined in section 272-105 in Schedule 2F of the ITAA 1936 (via Nominees), acquiring a Put Option (see below) and taking a limited recourse loan for 3, 4 or 5 years (the 'Loan') from Next Financial. Where the NF 300 Instalment involves the acquisition of a stapled security, the stapled security is comprised of share/s and unit/s that are jointly listed for quotation on the ASX;
- (b) the securities which are held for the Investor for a particular Instalment are referred to as the underlying securities and will comprise a basket of securities selected by Next Financial (the 'Underlying Securities'), as identified in the Rate Sheet and Confirmation. The Underlying Securities will not change throughout the life of the NF 300 Instalment

except in response to corporate action. The NF 300 Instalments will not be listed on the ASX, but Investors may transfer their NF 300 Instalments by private treaty in accordance with the Instalment Deed;

- (c) when the Investor's Intention is accepted, for each Instalment a Loan will be made to the Investor to purchase the Underlying Securities. The amount of the Loan for each Instalment ('Loan Amount') will be fixed by Next Financial (the 'Lender') and identified in the relevant Confirmation;
- (d) repayment of the Loan Amount will be secured by a charge in favour of Next Financial granted under the Instalment Deed (the 'Security Interest') over the Underlying Securities for each Instalment which are held by the Security Trustee on trust for the Investor (the 'Secured Property'). Each trust and each parcel of Underlying Securities for each Instalment will be kept as a separate trust and there will be no pooling of interests or property to which the trust relates;
- (e) the Investor will retain the beneficial interest in the Underlying Securities for each Instalment throughout the term of the NF 300 Instalments. During the term of the NF 300 Instalment the Investor will be registered as the legal owner of the NF 300 Instalment, while the Underlying Securities will remain registered in the name of the Security Trustee (or other nominated custodian) until the Security Interest is released or discharged;
- (f) the Loan for each Instalment by Next Financial will be provided on a limited recourse basis such that the Lender's right to repayment of principal will be limited to the amount which it can obtain by enforcing its rights in respect of the Secured Property. Next Financial will be entitled to exercise its Security Interest in respect of some or all of the Secured Property in case of any event of default by the Investor, such as a failure to pay interest and fees (if any) when due;
- (g) in all other respects the Lender's recourse against an Investor will not be limited;
- (h) interest on the Loan for each Instalment will be paid in advance via a number of instalments (the 'Interest Amounts'). The Loan Agreement states that the amount of interest payable for each interest period ('Interest Period'), and the time at which such amount

will be payable, will be as is initially specified in the Confirmation provided to the Investor;

- (i) the Investor is required to pay the Interest Amount that relates to the first Interest Period from their own funds. On the date that the Loan for each Instalment is drawn down (the 'Drawdown Date'), part of the Loan Amount will be applied to prepay a portion of the Interest Amount for each subsequent Interest Period. The Investor will pay the balance of the Interest Amount for each subsequent Interest Period in advance via annual instalments from their own funds. The Lender will notify the Investor in advance of each subsequent Interest Period of the balance of the Interest Amount owing;
- (j) an establishment fee will also be payable to the Lender on application in consideration for the grant of the Loan for each Instalment ('Establishment Fee');
- (k) during the period of the Loan, Investors will be entitled to the benefit of all dividends and distributions paid on the Underlying Securities. The Investor may also direct the Security Trustee in relation to attendance and voting at meetings of holders of the securities comprised in the Underlying Securities;
- (l) on acceptance of the Investor's Intention, Next Financial will also grant to the Investor a Put Option over the Underlying Securities for each Instalment entitling the Investor to require the Lender to purchase the Underlying Securities for each Instalment for the Loan Amount for that Instalment;
- (m) in consideration for the grant of the Put Option, a portion of the Interest Amounts will be allocated to the put premium, which is the amount attributed by the Lender to the grant of the Put Option and will be notified to Investors in the Confirmation ('Put Premium'). The Put Premium will be no less than the excess of the Interest Rate charged on the Loan above the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans and will be notified to Investors in the Confirmation;
- (n) at the final Maturity Date, or at any time prior to that date, Investors may exercise their Next Financial Instalments by repayment of the Loan Amount for an Instalment or may exercise the Put Option for that Instalment if the conditions for exercise are satisfied. Where the Instalment is completed, the Underlying

Securities will be transferred to the Investor free of any Security Interest;

- (o) Alternatively, where the market value of the Instalment at the Maturity Date is less than the relevant Loan Amount for that Instalment, and the Loan is not repaid at least five days prior to the Maturity Date, the Put Option will be automatically exercised and the Investor's interest in the Underlying Securities will be transferred to the Lender for the outstanding Loan Amount for that Instalment. The Lender will apply the amount payable to the Investor in respect of such transfer in satisfaction of the Investor's obligation to repay the Loan for that Instalment; and
- (p) if, at the final Maturity Date, the Investor does not repay the Loan for an Instalment and the Put Option is not exercised, the Lender will enforce its Security Interest and exercise its power of sale. The proceeds of sale will be applied in repayment of the balance of the Loan for that Instalment, any costs incurred by the Lender or the Security Trustee in relation to the sale, and any remaining proceeds will be paid to the Investor. Due to the limited recourse nature of the Loan, if the sale proceeds are insufficient to repay the Loan for that Instalment in full, the Investor will not be required to pay the shortfall.

The Participants

14. Next Financial is the Issuer of the NF 300 Instalment and also the Lender in connection with the acquisition of the Underlying Securities.

15. Nominees holds the legal title to the Underlying Securities as nominee and as Security Trustee for each Investor.

16. The Investors may be individuals or private companies, acting in their personal capacity or as trustees, including as trustees of complying superannuation funds.

Ruling

17. Subject to paragraph 2 of this Product Ruling:

- (a) the Interest Amount allowable as a deduction under section 8-1 of the ITAA 1997 is the amount that does not exceed the lower of the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans

and the relevant percentage of the total Interest Amounts charged under the Loan Agreement as follows:

- (i) 80% for 3 year Loans;
- (ii) 82.5% for 4 year Loans; and
- (iii) 85% for 5 year Loans.

Where the interest rate charged on a Loan is a variable rate the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans Variable is to be used, and where the interest rate charged is a fixed rate the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans Fixed is to be used;

- (b) the difference between the total Interest Amount and the deductible amount calculated under paragraph 17(a) is an instalment for the Put Premium and is not deductible under section 8-1 of the ITAA 1997;
- (c) section 51AAA of the ITAA 1936 will not deny an Investor a deduction for the portion of the Interest Amount that is deductible under section 8-1 of the ITAA 1997;
- (d) section 82KL of the ITAA 1936 will not apply to deny an Investor a deduction for the portion of the Interest Amount that is deductible under section 8-1 of the ITAA 1997;
- (e) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the portion of the Interest Amount that is deductible under section 8-1 of the ITAA 1997;
- (f) section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility for that part of the portion of the prepaid Interest Amount deductible under section 8-1 of the ITAA 1997 where the eligible service period for the Interest Period is not more than 12 months and ends on or before the last day of the year of income after the one in which the expenditure was incurred where at least one of the following applies for the year of income:
 - (i) the Investor is a Simplified Tax System ('STS') taxpayer; or
 - (ii) the Investor is an individual taxpayer who does not incur the expenditure in carrying on a business,

- (g) section 82KZM of the ITAA 1936 will apply to set the amount and timing of deductions for that part of the portion of the prepaid Interest Amount deductible under section 8-1 of the ITAA 1997 where the Interest Period to which the prepayment relates ends after the last day of the year of income after the one in which the expenditure was incurred and where one of the following applies for the year of income:
 - (i) the Investor is an STS taxpayer; or
 - (ii) the Investor is an individual taxpayer who does not incur the expenditure in carrying on a business;
- (h) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the portion of the prepaid Interest Amount deductible under section 8-1 of the ITAA 1997 to an Investor (other than an STS taxpayer for that year of income) who is a taxpayer that is not an individual and does not carry on a business. The deductible amount is calculated using the formula in subsection 82KZMD(2);
 - (i) the date that the Investor acquires the beneficial interest in the Underlying Securities is the date of acceptance of the Intention for the NF 300 Instalment;
 - (j) no CGT event arises when the legal title to the Underlying Securities is transferred by the Security Trustee to the Investor;
 - (k) if the Put Option is not exercised, the Put Premium forms part of the cost base of the Put Option under subsection 110-25(2) of the ITAA 1997;
 - (l) if the Put Option is exercised, the Put Premium will be included under section 134-1 of the ITAA 1997 in the Investor's cost base of the Underlying Securities;
 - (m) a CGT event will occur under section 104-25 of the ITAA 1997 if the Put Option is not exercised and lapses. The capital proceeds received on lapsing of the Put Option will be nil;
 - (n) a CGT event will arise under section 104-10 of the ITAA 1997 to the Investor where the Loan is not repaid and the Underlying Securities are sold by the Lender exercising its power of sale under the Security Interest. The cost base of the Underlying Securities will be reduced by the excess (if any) of the Loan Amount over

the market value of the Underlying Securities in accordance with the provisions of subsection 110-45(3) of the ITAA 1997. The capital proceeds will be the value received by the Lender on disposal of the Underlying Securities;

- (o) any capital gain realised by an Investor on sale of the Underlying Securities received pursuant to completion of a NF 300 Instalment, will be treated as a discount capital gain pursuant to section 115-5 of the ITAA 1997 where the Investor is an individual, a complying superannuation entity, or a trust and has held the NF 300 Instalment for at least 12 months;
- (p) only the Investors in NF 300 Instalments (and not the Security Trustee) are assessable on all of the income derived from the Underlying Securities while the Underlying Securities are the subject of the separate trust;
- (q) the Establishment Fee charged is deductible under section 25-25 of the ITAA 1997; and
- (r) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to an Investor in respect of NF 300 Instalments.

Assumptions

18. This Ruling is made on the basis of the following necessary assumptions:

- (a) the Investor is an Australian resident for taxation purposes;
- (b) the Investors are not traders in investments and are not treated for taxation purposes as trading in the Underlying Securities, carrying on a business of investing in the Underlying Securities, or holding the Underlying Securities as trading stock or as a revenue asset;
- (c) the interest paid from an Investor's own funds may be prepaid for each Interest Period but only in relation to Interest Periods of 12 months or less;
- (d) the Investor will derive assessable income from their investment in NF 300 Instalments. That assessable income will not include income other than dividends and capital gains;

- (e) the dominant purpose of an Investor in entering into the arrangement is to derive assessable income from their investment in NF 300 Instalments;
- (f) the arrangement will be executed in the manner described in the 'Arrangement' section of this Ruling; and
- (g) all dealings by the Investors and Next Financial will be at arm's length.

Explanation

Section 8-1 of the ITAA 1997: Deduction for Interest Expenses

19. The interest paid on 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 (Taxation Ruling TR 95/33).

20. Part of the interest charge under the Loan is allocated to the consideration for the Put Option (being the Put Premium). The Put Option ensures that the Investor is protected from liability to repay the principal if the market value of the Underlying Securities at Maturity is less than the outstanding Loan Amount. The Put Premium forms the cost base of the Put Option and is not deductible under section 8-1.

21. Investors should only claim deductions equal to the amount of interest on the Loan determined as follows – the lower of the applicable Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans or the applicable interest amounts as calculated in accordance with the formula described in paragraph 17(a).

Section 51AAA of the ITAA 1936

22. By acquiring the NF 300 Instalment it is contemplated that an Investor will derive assessable income by the receipt of dividends and capital gains. As interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA has no application to an Investor acquiring NF 300 Instalments.

Section 82KL of the ITAA 1936

23. 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

24. 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 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) to include amounts of less than \$1,000, or amounts of expenditure that are of a capital nature.

Subdivision 328 –F and Subdivision 328-G of the ITAA 1997

STS Taxpayers

25. 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 its choice to become such a taxpayer for that year.

26. An Investor will be eligible to be an STS taxpayer if the Investor carries on a business and the STS average turnover of the business and related businesses 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

27. The interest amount that is an allowable deduction under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest. 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 3, 4 or 5 years for NF 300 Instalments.

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

28. 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.

29. 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 NF 300 Instalments, including the financing, purchase, holding and disposal arrangements for the Underlying Securities.

30. Under the arrangement, when the Investor acquires NF 300 Instalments, they acquire beneficial ownership of the shares or units comprising the Underlying Securities.

31. Exception 1, as contained in subsection 82KZME(5), applies to exclude the portion of the Interest Amount deductible under section 8-1 of the ITAA 1997 incurred on borrowings under the NF 300 Instalments from the operation of section 82KZMF, as:

- (a) the prepaid interest expenditure under NF 300 Instalments is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX and/or units in a unit trust as described in subparagraph 82KZME(5)(b)(iii);
- (b) the Investor can reasonably be expected to obtain dividend or trust income from the investment;
- (c) the Investor will not obtain any other kind of assessable income from the investment, except for capital gains; and
- (d) all aspects of the NF 300 Instalments are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 32 to 38 below.

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

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

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

33. 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.

Prepayment of interest made at the commencement of annual Interest Periods

34. That part of the portion of the Interest Amount deductible under section 8-1 of the ITAA 1997 prepaid from an Investor's own funds at the commencement of an annual Interest Period, relates to an eligible service period that is not more than 12 months and which ends on or before the last day of the year of income after the one in which the expenditure was incurred. Therefore, section 82KZM will have no application to Investors who are STS taxpayers for the year of income, or to Investors who are individual taxpayers 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 that interest.

Prepayment of interest made on the Drawdown Date

35. That part of the portion of the Interest Amount deductible under section 8-1 of the ITAA 1997 prepaid on the Drawdown Date from the Loan funds, relates to subsequent annual Interest Periods and will be apportioned over the eligible service period in accordance with section 82KZM as the eligible service period for this expenditure is longer than 12 months.

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

36. Sections 82KZMA and 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 carry on a business.

37. 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.

38. For these taxpayers, the allowable deduction for the portion of the prepaid Interest Amount deductible under section 8-1 of the ITAA 1997 will be apportioned over the relevant Interest Period.

Sections 110-25 and 134-1 of the ITAA 1997: Cost Base of the Put Option

39. If the Put Option is not exercised, the portion of the Interest Amount which is not deductible to the Investor under section 8-1 of the ITAA 1997 forms the cost base of the Put Option under subsection 110-25(2) of the ITAA 1997.

40. If the Put Option is exercised, the portion of the Interest Amount which is not deductible to the Investor under section 8-1 of the ITAA 1997 will be included in the Investor's cost base of the shares or units comprising the Underlying Securities under section 134-1.

Section 104-25 of the ITAA 1997: CGT Event C2 in respect of the Put Option

41. If the Put Option lapses CGT event C2 will occur for the Investor. The capital proceeds received in respect of this event will be nil.

Section 109-5 of the ITAA 1997: Acquisition of a CGT asset

42. Section 109-5 applies to Investors to treat them as having acquired the Underlying Securities and the Put Option at the time from which the Investors obtain beneficial ownership of the Underlying Securities. This is the time that the Investor's Intention to purchase a NF 300 Instalment is accepted.

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

43. When the Investor completes the NF 300 Instalment, no CGT event will arise in respect of the transfer of the legal title to the Underlying Security from the Security Trustee to the Investor by virtue of subsection 104-10(7).

Section 104-10 of the ITAA 1997: CGT Event A1

44. A CGT event will arise to the Investor if the Investor does not complete the NF 300 Instalment and the Underlying Securities are sold by the Lender exercising its power of sale. The cost base of the Underlying Securities will be reduced by the excess (if any) of the Loan Amount over the market value of the Underlying Securities in accordance with the provisions of subsection 110-45(3) of the ITAA 1997. The capital proceeds will be the amount received by the Lender on disposal of the Underlying Securities.

Section 115-5 of the ITAA 1997: Discount capital gains

45. 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 received pursuant to the completion of a NF 300 Instalment will be treated as a discount capital gain where the Investor is an individual, a complying superannuation entity, or a trust and has held the NF 300 Instalment for at least 12 months.

Section 97 of the ITAA 1936

46. 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 25-25 of the ITAA 1997: Establishment Fee

47. The Establishment Fee incurred by an investor in relation to monies borrowed from Next Financial under the Loan Agreement will be an allowable deduction pursuant to section 25-25. The Establishment Fee will be deductible over the life of the Loan.

Part IVA of the ITAA 1936

48. Provided that the arrangement ruled on is entered into and carried out as disclosed (see paragraphs 11 to 16 above), it is accepted that the arrangement is a normal commercial transaction and Part IVA will not apply.

Detailed contents list

49. Below is a detailed contents list for this Product Ruling:

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Commissioner of Taxation

19 November 2003

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/1; TR 92/20; TD 93/34;
TR 95/33; TR 97/16; PR 1999/95

Subject references:

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

Legislative references:

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- ITAA 1936 82KL
- ITAA 1936 82KZL(1)
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- ITAA 1936 82KZM
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- ITAA 1936 82KZME(5)
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