



***PR 2004/108 - Income tax: tax consequences of investing in Westpac 'IWL' Series Instalments 2003 Product Disclosure Statement and 2004 Supplementary Product Disclosure Statements - cash applicants and on-market purchasers***

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 This document has changed over time. This is a consolidated version of the ruling which was published on 17 November 2004



## Product Ruling

# Income tax: tax consequences of investing in Westpac 'IWL' Series Instalments 2003 Product Disclosure Statement and 2004 Supplementary Product Disclosure Statements – cash applicants and on-market purchasers

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Potential participants may wish to refer to the Tax Office website at [www.ato.gov.au](http://www.ato.gov.au) or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

### **Preamble**

*The number, subject heading, **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.*

## **No guarantee of commercial success**

The Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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

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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

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling relates. In this Ruling the arrangement is the acquisition of Westpac 'IWL' Series Instalments (Westpac IWL Instalments) under the Product Disclosure Statement dated 19 December 2003 and Supplementary Product Disclosure Statements dated 18 June 2004, 25 June 2004 and 6 October 2004, which provide an investment in shares listed on the Australian Stock Exchange (ASX) and/or units in listed trusts and a put option (Put Option), using in part a loan made by Westpac Banking Corporation (Westpac).
2. This Ruling does not address:
  - a Holder's entitlement to franking credits; and
  - the tax consequences of the Reset Cash Back that is provided as a cash payment on a Reset Date.

### 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 of the ITAA 1997;
  - section 104-10 of the ITAA 1997;
  - section 104-25 of the ITAA 1997;
  - section 109-5 of the ITAA 1997;
  - section 110-25 of the ITAA 1997;
  - subsection 110-45(3) of the ITAA 1997;
  - section 112-35 of the ITAA 1997;
  - section 115-5 of the ITAA 1997;
  - section 116-20 of the ITAA 1997;
  - section 134-1 of the ITAA 1997;

- section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KL of the ITAA 1936;
- section 82KZM of the ITAA 1936;
- section 82KZMA of the ITAA 1936;
- section 82KZMD of the ITAA 1936;
- section 82KZME of the ITAA 1936;
- section 82KZMF of the ITAA 1936;
- section 97 of the 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 below, through Cash Applications or on-market purchases, on or after the date of this Ruling. They will have, at the time of entering into the arrangement, 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 'Holders'.

5. This Ruling does not address the tax consequences for persons who apply under Securityholder Applications (Securityholder Applicants) or Rollover Applications (Rollover Applicants). These application methods are disclosed and described in the Product Disclosure Statement.

**Qualifications**

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

7. 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

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9. This Ruling applies prospectively from 17 November 2004, 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).

10. 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

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11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2008. 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

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

- application for a Product Ruling dated 10 September 2004 received from Allens Arthur Robinson on behalf of Westpac;
- Deed Poll – Declaration of Trust dated 18 December 2003 executed by the Security Trustee;

- Deed Poll – Warrant Terms dated 18 December 2003 executed by Westpac;
- Product Disclosure Statement for Westpac Instalments dated 19 December 2003 (which includes the terms of the Loan Agreement);
- Supplementary Product Disclosure Statements for Westpac Instalments dated 18 June 2004, 25 June 2004 and 6 October 2004 (Supplementary Product Disclosure Statements); and
- further information received on 20 October 2004.

13. In this Ruling, unless otherwise defined, capitalised terms take their meaning as in the Product Disclosure Statement.

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

- (a) Westpac IWL Instalments are a leveraged investment under which a Holder acquires a beneficial interest in shares listed on the ASX and/or units in certain listed trusts (Security) using a limited recourse Loan made by Westpac. The Security, together with any attached Accretions, is referred to as the 'Underlying Parcel'. Where the Underlying Parcel includes a stapled security, the stapled security comprises share/s and unit/s that are jointly listed for quotation on the ASX;
- (b) the Loan Amount is determined by Westpac having regard to the value of the Underlying Parcel. For Westpac IWL Instalments, the Loan Amount is set at approximately 70-95% of the value of the Underlying Parcel. The Supplementary Product Disclosure Statements specify the Loan Amount for Westpac IWL Instalments over each Security. The Loan Amount is fixed until the first Reset Date at which time Westpac may reset the Loan Amount having regard to movements in the value of the Underlying Parcel;
- (c) interest on the Loan is payable annually in advance for the period to the next Reset Date (the Interest Amount);
- (d) repayment of the Loan is secured by a mortgage over the Underlying Parcel. Legal title to the Underlying Parcel is held by the Security Trustee on trust for the Holder. Each Underlying Parcel is held on a Separate Trust and there is no pooling of interests or property to which the trust relates;
- (e) Holders may repay the Loan on any Reset Date or the Completion Payment Date by providing a Completion Payment Notice to Westpac together with the amount of the Completion Payment. The Completion Payment is an amount equal to the Loan Amount. On making the Completion Payment, the Loan owing to Westpac

will be repaid and the Security Interest over the Underlying Parcel will be discharged. The Security Trustee will deliver legal title to the Underlying Parcel to the Holder;

- (f) the Loan is provided on a limited recourse basis so that if the Holder does not make the Completion Payment, Westpac's right to repayment is limited to the proceeds which it can obtain from enforcing its Security Interest over the Underlying Parcel. If the Holder provides a Completion Payment Notice to Westpac, however, Westpac is entitled to recover the Completion Payment from the Holder in full;
- (g) Westpac grants the Holder a Put Option on Cash Application and on each Reset Date. The Put Option is exercisable on the next Reset Date or, in respect of the Put Option granted on the final Reset Date, the Completion Date. As consideration for each Put Option, the Holder is charged a Put Option Fee on Cash Application and each Reset Date;
- (h) Westpac IWL Instalments are open to investment by three types of investors, one of which is Cash Applicants. A Cash Applicant is a person who acquires a Westpac IWL Instalment by way of Cash Application. A Cash Application must be accompanied by the First Payment. The First Payment consists of:
  - the Capital Component which is used to partly fund the acquisition of the Underlying Parcel by the Security Trustee;
  - the Interest Amount;
  - the Put Option Fee which is the cost of Westpac providing the Holder with the Put Option to the next Reset Date; and
  - Borrowing Fees, if any, which relate to Westpac's cost of providing the Loan including placement fees paid to financial advisers.

The Capital Component is applied, together with the proceeds of the Loan towards the acquisition of the Underlying Parcel by the Security Trustee;

- (i) Westpac IWL Instalments are also listed on the ASX so that investors may participate by purchasing Westpac IWL Instalments on-market;
- (j) where a Westpac IWL Instalment is purchased on the ASX, the purchaser acquires the Westpac IWL Instalment on the same terms as the seller. In particular, the purchaser acquires the beneficial interest in the Underlying Parcel and accepts a Loan from Westpac. The Loan provided to the purchaser is

applied to pre-pay interest on the purchaser's Loan to the next Reset Date (which is used to refund part of the interest prepaid by the seller), and discharge the seller's Loan;

- (k) during the life of the Westpac IWL Instalment, Holders will be entitled to all dividends and distributions paid on a Security in the Underlying Parcel (Special Dividends, however, may be applied by the Security Trustee in reduction of the Completion Payment). A Holder is not entitled to direct the Security Trustee to exercise any voting rights in relation to a Security;
- (l) there are seven annual Reset Dates specified in the Supplementary Product Disclosure Statements. On each Reset Date, Westpac may reset the Loan Amount having regard to the value of the Underlying Parcel. The Interest Amount, the Put Option Fee and Borrowing Fees (if any) are payable on each Reset Date. Holders have a number of options on a Reset Date:
  - make the Completion Payment and acquire legal title to the Underlying Parcel;
  - exercise the Put Option and sell the Underlying Parcel to Westpac for a price equal to the greater of the Market Value or the Completion Payment. Holders receive the balance of the proceeds (if any) after payment of the Completion Payment;
  - if the reset Loan Amount is greater than the Current Loan Amount by an amount more than the sum of the Interest Amount, Put Option Fee and Borrowing Fees (if any), the Holder may receive additional Westpac IWL Instalments;
  - if the reset Loan Amount is equal to or less than the Current Loan Amount, or is greater than the Current Loan Amount by an amount less than the sum of the Interest Amount, the Put Option Fee and the Borrowing Fees (if any), the Holder may make a Reset Payment to Westpac in order to continue to hold the same number of Westpac IWL Instalments. If the Holder fails to make the Reset Payment in these circumstances, Westpac is entitled to enforce its Security Interest over the Underlying Parcel to repay the outstanding balance of the Loan Amount. Where the sale proceeds exceed the outstanding Loan Amount and any other selling costs incurred by Westpac, Westpac may apply the proceeds to make the Reset Payment in respect of other Westpac Instalments of the



Holder for which no Reset Payment was received, or provide the Holder the excess. Due to the limited recourse nature of the Loan, if the sale proceeds obtained by Westpac are less than the outstanding Loan, Westpac is not entitled to recover the balance from the Holder; or

- if offered, apply to rollover the Westpac IWL Instalments to a future series of Westpac Instalments; and
- (m) at the Completion Payment Date the following options are available to Holders of Westpac IWL Instalments:
- make the Completion Payment and acquire legal title to the Underlying Parcel;
  - exercise the Put Option and sell the Underlying Parcel to Westpac for a price equal to the greater of the Market Value or the Completion Payment. Holders receive the balance of the proceeds (if any) after payment of the Completion Payment;
  - do nothing, in which case Westpac may enforce its Security Interest over the Underlying Parcel to repay the outstanding balance of the Loan Amount. Where the sale proceeds exceed the outstanding Loan Amount and any other selling costs incurred by Westpac, the Holder is entitled to receive the excess. Due to the limited recourse nature of the Loan, if a Completion Payment Notice has not been provided by the Completion Payment Date, and the sale proceeds obtained by Westpac are less than the outstanding Loan Amount, Westpac is not entitled to recover the balance from the Holder; or
  - if offered, apply to rollover the Westpac IWL Instalments to a future series of Westpac Instalments.

## Participants

15. Westpac is the Issuer of the Westpac IWL Instalments and is also the provider of the Loans to Holders to fund the acquisition of the Underlying Parcel.

16. Perpetual Trustee Company Limited holds the legal title to each Underlying Parcel for each Holder as Security Trustee.

17. The Holders may be individuals, companies, trusts or superannuation funds.

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## Ruling

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18. Subject to paragraphs 2 and 19 of this Ruling:
- (a) the Interest Amount paid by a Holder is deductible to the Holder under section 8-1 of the ITAA 1997;
  - (b) section 51AAA of the ITAA 1936 will not apply to deny a Holder a deduction for the Interest Amount 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 Amount 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 an Interest Amount incurred under a Westpac IWL Instalment;
  - (e) section 82KZM of the ITAA 1936 will not apply to deny immediate deductibility for an Interest Amount incurred by the Holder under a Westpac IWL Instalment where at least one of the following applies for the year of income:
    - the Holder is a Simplified Tax System (STS) taxpayer; or
    - the Holder is an individual who does not incur the expenditure in carrying on a business;
  - (f) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the Interest Amount incurred under a Westpac IWL Instalment that is deductible to a Holder (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;
  - (g) any Borrowing Fee charged on application and on each Reset Date is deductible under section 25-25 of the ITAA 1997 over the shorter of 5 years and the remaining period of the Loan;
  - (h) if the Holder's Put Option is not exercised, the Put Option Fee will be included in the Holder's cost base of the Put Option under section 110-25 of the ITAA 1997;
  - (i) if the Holder's Put Option is exercised, the Put Option Fee will be included under section 134-1 of the ITAA 1997 in the Holder's cost base of the Underlying Parcel;

- (j) for on-market purchasers the cost base of the Put Option will be:
  - (i) if the market value of the Underlying Parcel at the time of purchase is greater than the purchaser's Loan Amount, the cost base of the Put Option, determined under sections 110-25 and 112-35 of the ITAA 1997, is the price of the Westpac IWL Instalment plus the purchaser's Loan Amount less the sum of the market value of the Underlying Parcel and the Interest Amount prepaid by the purchaser on the Loan Amount; and
  - (ii) if the market value of the Underlying Parcel at the time of purchase is less than the purchaser's Loan Amount, the cost base of the Put Option, determined under sections 110-25 and 112-35 of the ITAA 1997, is the price of the Westpac IWL Instalment plus the purchaser's Loan Amount less the sum of the purchaser's Loan Amount and the Interest Amount prepaid by the purchaser on the Loan Amount;
- (k) for on-market purchasers the amount determined under paragraph 18(j) will be included in the cost base of the Underlying Parcel under section 134-1 of the ITAA 1997 if the Put Option is exercised;
- (l) for on-market purchasers the amount determined under paragraph 18(j) will be included in the cost base of the Put Option under section 110-25 of the ITAA 1997 if the Put Option is not exercised;
- (m) capital gains tax (CGT) event C2 will occur under section 104-25 of the ITAA 1997 on a Reset Date or Completion Payment Date if the Put Option is not exercised and lapses. The capital proceeds received on lapsing of the Put Option will be nil under section 116-20 of the ITAA 1997;
- (n) the date of acquisition of the beneficial interest in the Underlying Parcel under section 109-5 of the ITAA 1997 is, in the case of a Cash Applicant, the date of acceptance of the application, or in the case of an on-market purchaser of Westpac IWL Instalments, the contract date for transfer of the Westpac IWL Instalments;
- (o) no CGT event arises when the legal title to the Underlying Parcel is transferred by the Security Trustee to the Holder on completion of the Westpac IWL Instalment by virtue of subsection 104-10(7) of the ITAA 1997;

- (p) CGT event A1 will arise under section 104-10 of the ITAA 1997 to the Holder where the Completion Payment is not made or a Reset Payment is not made and the Underlying Parcel is sold by Westpac exercising its power of sale under the Security Interest. The cost base in the Underlying Parcel will be reduced by the excess (if any) of the Loan Amount over the market value of the Underlying Parcel under subsection 110-45(3) of the ITAA 1997. The capital proceeds will be the amount received by Westpac on disposal of the Underlying Parcel;
- (q) any capital gain realised by a Holder on sale of an Underlying Parcel received pursuant to completion of a Westpac IWL Instalment, will be treated as a discount capital gain under section 115-5 of the ITAA 1997 where the Holder is an individual, a complying superannuation entity, or a trust and has held the Westpac IWL Instalment for at least 12 months;
- (r) all of the income derived from the Underlying Parcel while the Underlying Parcel is the subject of the separate trust will be included in the assessable income of the Holder of Westpac IWL Instalments (and not the Security Trustee) under section 97 of the ITAA 1997; and
- (s) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to deny deductibility of the interest incurred by a Holder in respect of the Westpac IWL Instalment.

## **Assumptions**

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19. This Ruling is made on the basis of the following assumptions:
- (a) all of the Holders are Australian residents for taxation purposes;
  - (b) the Holders are not traders in investments and are not treated for taxation purposes as either trading in the Underlying Parcel, carrying on a business of investing in the Underlying Parcel, or holding the Underlying Parcel as trading stock or as a revenue asset;
  - (c) the interest for each interest payment period may be prepaid by the Holders but only in relation to interest payment periods 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 a Holder in entering the arrangement is to derive assessable income from their investment in the Westpac IWL Instalments;

- (e) at all times during the arrangement, where the Underlying Parcel includes units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (f) the arrangement will be executed in the manner described in the 'Arrangement' section of this Ruling;
- (g) all dealings by the Holders and Westpac will be at arm's length; and
- (h) the Underlying Parcel will not be the subject of any securities lending arrangement entered into by or on behalf of the Holder.

## Explanation

### Section 8-1 of the ITAA 1997

20. The interest paid on a borrowing used to acquire income producing assets such as shares and/or units is generally treated as deductible under section 8-1 where it is expected that dividends or other assessable income would be derived from the investment (see Taxation Ruling TR 95/33). Interest incurred by a Holder in relation to monies borrowed from Westpac under the Loan will be an allowable deduction pursuant to section 8-1 to the extent that the interest is incurred by the Holder in gaining or producing assessable income. This is the case regardless of whether the Holder acquired the Westpac IWL Instalment by Cash Application or by purchase on the ASX. No part of the interest charged by Westpac under the Loan is a capital protection fee. Capital protection under the arrangement is provided by the Put Option.

### Section 51AAA of the ITAA 1936

21. By acquiring the Westpac IWL Instalment it is contemplated that a Holder will derive assessable income by the receipt of dividends, trust income and/or 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 a Holder acquiring the Westpac IWL Instalment.

### Section 82KL of the ITAA 1936

22. 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**

23. 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 Holder is an STS taxpayer, whether the Holder is an individual and whether the Holder 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 of expenditure that are of a capital nature.

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

24. A Holder will be an STS taxpayer for an income year if the Holder is eligible to be an STS taxpayer for that year and the Holder notifies the Commissioner of the choice to become such a taxpayer for that year.

25. A Holder will be eligible to be an STS taxpayer for an income year if the Holder 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***

26. 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 or less, and not to the period of the Loan.

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

27. 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.

28. 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 a Westpac IWL Instalment, including the financing, the purchase of a Security, the holding of a Security and the disposal arrangements.

29. Under the arrangement, when the Holder acquires a Westpac IWL Instalment, the Holder acquires beneficial ownership of the Underlying Parcel.

30. Exception 1, as contained in subsection 82KZME(5), applies to exclude the Interest Amount incurred on borrowings under the Westpac IWL Instalments from the operation of section 82KZMF, as:

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

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 31 to 36.

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

31. 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.

32. 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.

33. As the eligible service period in relation to the deductible interest for Westpac IWL 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 Holders who are STS taxpayers for the year of income, or to Holders who are individuals and the expenditure is not incurred in carrying on a business. Holders who satisfy these tests will be able to claim an immediate deduction for the interest incurred.

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

34. Sections 82KZMA and 82KZMD set the amount and timing of deductions for expenditure for a Holder (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.

35. 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.

36. For these taxpayers, the deduction for the prepaid Interest Amount on the Westpac IWL Instalment will be apportioned over the relevant interest payment period.

**Borrowing Fee**

37. Borrowing Fees, if any, relate to the cost of Westpac making the Loan available to the Holder. As the Loan funds are used for income producing purposes, any Borrowing Fees charged on Cash Application or on a Reset Date will be deductible under section 25-25 of the ITAA 1997 over the shorter of 5 years and the remaining term of the Loan.



## **Put Option Fee**

### ***Cost base of the Put Option – Cash Applicants and Holders on a Reset Date***

38. If the Put Option is not exercised, the Put Option Fee paid by a Cash Applicant or a Holder on a Reset Date will be included in the Cash Applicant's or Holder's cost base of the Put Option under section 110-25 of the ITAA 1997.

39. If the Put Option is exercised, the Put Option Fee paid by a Cash Applicant or a Holder on a Reset Date will be included in the Cash Applicant's or Holder's cost base of the Security comprising the Underlying Parcel under section 134-1 of the ITAA 1997.

### ***Cost base of the Put Option – on-market purchasers***

40. If the market value of the Underlying Parcel at the time of purchase is greater than the purchaser's Loan Amount, the cost base of the Put Option, determined under sections 110-25 and 112-35 of the ITAA 1997, is the price of the Westpac IWL Instalment plus the purchaser's Loan Amount less the sum of the market value of the Underlying Parcel and the interest prepaid by the purchaser on the Loan Amount.

41. If the market value of the Underlying Parcel at the time of purchase is less than the purchaser's Loan Amount, the cost base of the Put Option, determined under sections 110-25 and 112-35, is the price of the Westpac IWL Instalment plus the purchaser's Loan Amount less the sum of the purchaser's Loan Amount and the interest prepaid by the purchaser on the Loan Amount.

42. If the Put Option is not exercised, the amount determined under paragraph 18(j) is included in the cost base of the Put Option under section 110-25.

43. If the Put Option is exercised, the amount determined under paragraph 18(j) is included in the cost base of the Underlying Parcel under section 134-1 of the ITAA 1997.

## **Section 109-5 of the ITAA 1997 – acquisition of a CGT asset**

44. Section 109-5 applies to Holders to treat them as having acquired the Underlying Parcel and the Put Option at the time from which the Holders obtain beneficial ownership of the Underlying Parcel. This time is, for a Cash Applicant, the time the application was accepted, and for an on-market purchaser, the contract date for the transfer of the Westpac IWL Instalment.

**Subsection 104-10(7) of the ITAA 1997 – no CGT event when Completion Payment made**

45. 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 Holder by virtue of subsection 104-10(7).

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

46. A CGT event will arise to the Holder if the Holder does not make the Completion Payment or a Reset Payment and the Underlying Parcel is sold by Westpac. The cost base in the Underlying Parcel will be reduced by the excess (if any) of the Loan Amount over the market value of the Underlying Parcel in accordance with subsection 110-45(3) of the ITAA 1997. The capital proceeds will be the amount received by Westpac on disposal of the Underlying Parcel in accordance with section 116-20 of the ITAA 1997.

**Section 115-5 of the ITAA 1997 – discount capital gains**

47. Division 115 of the ITAA 1997 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5, any capital gain realised by a Holder on the sale of the Westpac IWL Instalment or on the sale of the Underlying Parcel received pursuant to the completion of a Westpac IWL Instalment will be treated as a discount capital gain where the Holder is an individual, a complying superannuation entity, or a trust and has held the Westpac IWL Instalment for at least 12 months.

**Section 97 of the ITAA 1936**

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

**Part IVA of the ITAA 1936**

49. Provided that the arrangement ruled on is entered into and carried out as disclosed (see the Arrangement part of this Ruling), it is accepted that the arrangement is an ordinary commercial transaction and Part IVA will not apply.

## Detailed contents list

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**Commissioner of Taxation**  
17 November 2004

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<i>Previous draft:</i>	- ITAA 1936 82KZMA
Not previously issued in draft form.	- ITAA 1936 82KZMD
	- ITAA 1936 82KZME
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZME(4)
TR 92/1; TR 92/20; TR 95/33,	- ITAA 1936 82KZME(5)
TR 97/16; TD 93/34; PR 1999/95	- ITAA 1936 82KZME(5)(b)(iii)
	- ITAA 1936 82KZMF
<i>Subject references:</i>	- ITAA 1936 97
- financial products	- ITAA 1936 Pt IVA
- interest expenses	- ITAA 1997 8-1
- prepaid expenses	- ITAA 1997 25-25
- product rulings	- ITAA 1997 104-10
- public rulings	- ITAA 1997 104-10(7)
- small business taxpayer	- ITAA 1997 104-25
- tax avoidance	- ITAA 1997 109-5
- taxation administration	- ITAA 1997 110-25
	- ITAA 1997 110-45(3)
	- ITAA 1997 112-35
<i>Legislative references:</i>	- ITAA 1997 Div 115
- TAA 1953 Pt IVAAA	- ITAA 1997 115-5
- ITAA 1936 51AAA	- ITAA 1997 116-20
- ITAA 1936 82KL	- ITAA 1997 134-1
- ITAA 1936 Pt III Div 3 Subdiv H	- ITAA 1997 Subdiv 328-F
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- ITAA 1936 82KZL(2)(a)	- Copyright Act 1968
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