



PR 2004/56 - Income tax: deductibility of interest incurred on borrowings in relation to the Macquarie Fusion Funds - June 2004 Offer

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 This document has changed over time. This is a consolidated version of the ruling which was published on *12 May 2004*



Product Ruling

Income tax: deductibility of interest incurred on borrowings in relation to the Macquarie Fusion Funds – June 2004 Offer

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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, **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 IVA 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 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 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 investment in a Macquarie Fusion Fund using a loan made by Macquarie Bank Ltd (the 'Bank'); a further borrowing from the Bank, if it occurs, used to fund a payment of interest; and the grant of a put option ('Put Option') by the Bank.

2. This Ruling does not deal with the tax consequences of:

- using a Profit Loan;
- acquiring a Put Option without also drawing down an Investment Loan; and
- fees paid by a Fusion Fund - Equity Trust or the Fusion Fund - Cash Trust.

Tax law(s)

3. The tax law(s) 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 110-25 (ITAA 1997);
- Division 134 (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); 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 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 involvement as set out in the description of the arrangement. In this Ruling these persons are referred to as 'Investor(s)'.

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 12 May 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).

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 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 2007. The Ruling continues to apply, in respect of the tax law(s) 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 of the arrangement incorporates the following documents:

- application for a Product Ruling dated 25 March 2004 received from Macquarie Financial Products Management Limited as responsible entity ('Responsible Entity' or 'RE') for the Fusion Fund – Equity Trusts and the Fusion Fund - Cash Trust;
- Product Disclosure Statement for the Macquarie Fusion Funds (the 'PDS'). The PDS is comprised of a Master Document dated 30 January 2004 and a draft Offer Document dated 29 April 2004;
- Loan and Security Agreement (included in the PDS as section 10 of the Master Document);
- Put Option Agreement (included in the PDS as section 11 of the Master Document);
- Constitution for a Fusion Fund - Equity Trust (an 'Equity Trust'). The constitution for each Equity Trust is the same in all material respects other than the description of the Underlying Managed Fund into which the Equity Trust will invest; and
- Constitution for the Fusion Fund - Cash Trust (the 'Cash Trust').

12. 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.

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

- (a) an investment in a Macquarie Fusion Fund involves the subscription for units in one of a number of Equity Trusts together with the subscription for corresponding units in the Cash Trust. The combined investment in an Equity Trust and the Cash Trust is referred to as units in a 'Fund';
- (b) Investors subscribe for units in a Fund pursuant to the PDS. Investors will initially be required to invest 99.99% of their investment amount in one or more Equity Trusts and 0.01% of their investment in the Cash Trust;
- (c) all units in an Equity Trust will be issued at a price based on the prevailing net asset value of that Equity Trust and will be issued as fully paid units;
- (d) each Equity Trust will invest all application monies in an existing Australian public unit trust or a portfolio of Australian public unit trusts ('Underlying Managed Fund'). Each Equity Trust will invest in a different Underlying Managed Fund. The Underlying Managed Funds are not listed on any stock exchange;
- (e) all units in the Cash Trust will be issued as partly paid units with a paid up amount of \$0.0001 and an effective unpaid amount of \$1.4999;
- (f) the Cash Trust will be divided into pools of assets ('Property Pools'), each consisting of fixed term deposits or similar investments. There will be a different Property Pool for each class of units in the Cash Trust. Each class of unit will correspond to units in an Equity Trust issued on particular dates. All units in a particular class will have identical rights to the income and capital of the Property Pool to which that class relates;
- (g) the RE will manage an Investor's investment in the Equity Trust and the Cash Trust according to a technique known as 'Threshold Management'. This technique attempts to achieve the result that the value of an Investor's combined investment in the Equity Trust and the Cash Trust, including units acquired by the reinvestment of income, at the end of a period of approximately 5 years after their initial investment is made (the 'Threshold Management Period') will be at least equal to the amount of their combined initial investment. The achievement of that result is, however, not guaranteed;
- (h) under Threshold Management, if the value of an Investor's units in a Fusion Fund falls below a sell

trigger the Investor is deemed to have given a redemption request in respect of some of the Investor's units in the Equity Trust. The RE will redeem some of the Investor's units in that Equity Trust and apply the proceeds of that redemption to further pay up an amount on that Investor's corresponding units in the Cash Trust;

- (i) alternatively, if the value of an Investor's units in a Fusion Fund rises above a buy trigger, the RE may make a return of capital on the Investor's units in the Cash Trust and apply the proceeds to subscribe for further units in the corresponding Equity Trust on behalf of the Investor. This return of capital increases the amount which the RE, in accordance with Threshold Management, can call up on those units at a later time, hence fixing the effective maximum net paid up amount on the Cash Units at \$1.50 per unit;
- (j) the Equity Trust will invest all monies received pursuant to Threshold Management in the relevant Underlying Managed Fund;
- (k) the Cash Trust will invest all further amounts paid up in respect of its units pursuant to Threshold Management in fixed term deposits or similar investments;
- (l) the RE will be entitled to a fee for acting as responsible entity of each Equity Trust equal to a certain percentage per annum of the value of the assets of that Equity Trust. The RE will not be entitled to a fee for acting as responsible entity of the Cash Trust;
- (m) the distributable income of each Equity Trust and the Cash Trust for each year will be, at a minimum, the net taxable income of the Equity Trust or Cash Trust determined in accordance with section 95 of the ITAA 1936 (less any amount included in net taxable income which is not yet received or receivable). Each Equity Trust and the Cash Trust will distribute all of its distributable income each year;
- (n) the RE has the discretion whether to accept a request by an Investor for the redemption of their units in the Equity Trust and the Cash Trust during the Threshold Management Period. If a redemption request is accepted, the redemption proceeds will be calculated on the basis of the net asset value of the relevant Equity Trust and the net asset value of the relevant Property Pool in the Cash Trust at the time of redemption. The redemption payment for a unit in an Equity Trust, to the extent that it exceeds the application price for that unit, may include a distribution of the distributable income of that Trust. Similarly, the redemption payment for a unit in the Cash Trust, to the

extent that it exceeds the effective paid up amount for that unit, may include a distribution of the distributable income of that trust;

- (o) in the exercise of Threshold Management, the RE may require an Investor to reinvest some or all of their distribution or redemption payments into new units in the Equity Trust or into capital subscriptions to further pay up units in the Cash Trust;
- (p) each Equity Trust and the Cash Trust will be an open-ended trust with a termination date no later than 80 years from its commencement;
- (q) none of the Equity Trusts nor the Cash Trust will be listed;
- (r) there are three credit facilities available to finance an investment in a Fund. One is an Investment Loan to enable Investors to fund the initial subscription for their units in a Fund. The second is an Interest Loan which allows the Investor to fund a substantial portion of the first full financial year's interest prepayment on the Investment Loan (if the Investor prepays that interest and wishes to take out an Interest Loan to fund part of that prepayment). The third is a Profit Loan which, if made available, will allow a further loan to be drawn down if the value of the investment increases to certain levels;
- (s) the term of an Investment Loan will be five years, ending on 30 June 2009 (the 'Maturity Date'). The interest rate will be determined by the Bank prior to the drawdown of the Investment Loan and in some cases may be varied during the term of the Investment Loan;
- (t) an Investor has 3 interest rate and payment options:
 - (i) Variable

Interest is paid monthly in arrears for the term of the Investment Loan at an interest rate that may be varied each month. Investors who use this option may be given the choice to pay their interest annually in advance (at a discounted interest rate) from 30 June 2005;
 - (ii) fixed to 29 June 2005

Interest is paid annually in advance on each 30 June for the term of the Investment Loan at an interest rate which is fixed until 29 June 2005 and which may be varied each 30 June thereafter. Investors who use this option may be given the choice to pay their interest monthly in arrears from 30 June 2005; and

- (iii) fixed for the term
Interest is paid annually in advance on each 30 June for the term of the Investment Loan at an interest rate which is fixed for the term;
- (u) an Investor may repay that Investment Loan from their own sources and continue to hold units in the Fund;
- (v) the interest rate on an Interest Loan taken out as at 30 June 2004 will be the same as the interest rate on the Investment Loan. Interest under an Interest Loan must be paid annually 12 months in advance on 30 June (or, if that is a non-business day, on the immediately preceding day), and the principal must be repaid on the Maturity Date (or earlier if specified in the Loan and Security Agreement);
- (w) the Loan and Security Agreement provides for full recourse for the Bank in respect of the principal owing on an Investment Loan and an Interest Loan at the Maturity Date (or earlier if the loans become payable before the Maturity Date);
- (x) Investors may also be required to pay a loan establishment fee ('Establishment Fee') to the Bank upon successful application for an Investment Loan;
- (y) Investors who borrow from the Bank will also be required to buy a Put Option from the Bank. The exercise price of the Put Option is the higher of the amount of the Investment Loan (plus the Profit Loan if one is taken out) and the value of the Fusion Fund units at the Settlement Date of the option. If exercised, the Bank agrees to buy the Investor's units at the exercise price on the Settlement Date (expected to be on or soon after 30 June 2009). These proceeds are to be offset against the amounts outstanding on the Investment Loan (and any profit loan); and
- (z) the cost of the Put Option ('Protection Fee') is a fixed percentage of the Investor's initial investment amount and is payable either monthly in arrears or annually in advance to coincide with the interest payment obligations on the Investor's Investment Loan.

The Participants

14. Macquarie Financial Products Management Limited is the issuer of the PDS and the Responsible Entity. The Bank is the provider of the Investment Loans used to acquire the units in a Fund and also the Interest Loans used to fund part payment of interest in respect of the Investment Loan.

15. The Investors may be individuals, companies or trusts.

Ruling

16. Subject to paragraphs 2 and 17 of this Ruling:
- (a) the interest charge on an Investment Loan allowable under section 8-1 of the ITAA 1997 in a particular income year, is the amount of the sum of the interest charge and the Protection Fee, that does not exceed the lower of:
 - the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans – Fixed; or
 - the relevant percentage, being 85% for the Investment Loan;
 - (b) the difference between the sum of the interest charge on the Investment Loan and the Protection Fee and the deductible amount as calculated in paragraph 16(a), represents the payment for the Put Option ('Put Premium') and is not deductible under section 8-1 of the ITAA 1997;
 - (c) each interest amount paid by an Investor in respect of borrowings under an Interest Loan used to fund the interest on the Investment Loan will be allowable as a deduction to the Investor under section 8-1 of the ITAA 1997 to the same extent that a deduction is allowable for the corresponding Investment Loan interest (as described in paragraph 16(a)). That is, the lower of:
 - the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans – Fixed; or
 - the relevant percentage, being 85% for the Interest Loan;

The non-deductible portion of the interest on the Interest Loan represents a further payment of the Put Premium;
 - (d) 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;
 - (e) section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest allowable under section 8-1 of the ITAA 1997;
 - (f) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the prepaid interest allowable under section 8-1 of the ITAA 1997

in respect of borrowings under an Investment Loan and an Interest Loan;

- (g) section 82KZM of the ITAA 1936 will not apply to deny an Investor immediate deductibility of the prepaid interest on an Investment Loan or an Interest Loan 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 that 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 prepaid interest on borrowings under an Investment Loan and an Interest Loan that is allowable under section 8-1 of the ITAA 1997 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;
- (i) if the Investor exercises the Put Option, the Put Premium will form part of the cost base of the Investor's units in the Fund under subsection 134-1 of the ITAA 1997. Any gain or loss on exercise of the Put Option will be disregarded;
- (j) if the Put Option is not exercised, the Put Premium will form part of the cost base of the Put Option under subsection 110-25(2) of the ITAA 1997;
- (k) a CGT event will occur under section 104-25 of the ITAA 1997 if the Investor does not exercise the Put Option and it expires. The Investor will make a capital loss equal to the cost base of the Put Option;
- (l) the Establishment Fee paid, if applicable, is deductible under section 25-25 of the ITAA 1997; and
- (m) the anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny the deductibility of the interest incurred by the Investor in respect of borrowings under an Investment Loan or an Interest Loan.

Assumptions

17. This ruling is made on the basis of the following necessary assumptions:

- (a) the Investor is an Australian resident for taxation purposes;

- (b) the dominant purpose of the Investor in entering into the arrangement is to derive assessable trust income or both assessable trust income and a capital gain from their investment in a Fund;
- (c) the Investors are not traders in investments and are not treated for taxation purposes as trading in interests in a Fund, carrying on a business of investing in a Fund, or holding their interests in a Fund as trading stock or as a revenue asset;
- (d) in respect of any interest amounts paid in advance under either the Investment Loan or the Interest Loan, these may be prepaid, but only in relation to a payment period of 12 months or less that ends on or before the last day of the income year following the expenditure year;
- (e) the arrangement will be executed in the manner described in the 'Arrangement' section of this Ruling;
- (f) all dealings between the Investors and a Fund will be at arm's length;
- (g) at the time of the prepayment each of the two unit trusts comprising a Fund will have at least 300 unitholders;
- (h) neither the Investment Loan nor the Interest Loan will extend beyond the original Maturity Date; and
- (i) the Investors will not repay the Investment Loan or the Interest Loan prior to maturity or terminate the arrangement early.

Explanation

Section 8-1 of the ITAA 1997

18. Interest paid on a borrowing used to acquire income producing assets such as units in a trust, is generally treated as deductible under section 8-1 where it is expected that assessable income would be derived from the investment (see Taxation Ruling TR 95/33).

19. Investors should only claim deductions for an amount of the sum of the interest charge and the Protection Fee, that does not exceed the lower of:

- the applicable Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans – Fixed; and
- the relevant percentage, being 85% for the Investment Loan.

20. The difference between the sum of the interest charge under the Investment Loan and the Protection Fee and the deductible amount as calculated in paragraph 16(a) is allocated to the cost of acquiring the Put Option. The Put Option ensures that the Investor is protected from liability to repay the Investment Loan if the value of the Investor's units in the Fund applicable to that loan fall below the amount borrowed under that loan. The Put Premium is a capital protection fee and is not deductible under section 8-1.

21. Interest incurred on an Interest Loan is deductible under section 8-1 to the same extent that a deduction is allowable for the corresponding Investment Loan interest (as described in paragraph 16(c)). The non-deductible portion of the interest on the Interest Loan is also a payment of the Put Premium and is not deductible under section 8-1.

Section 51AAA of the ITAA 1936

22. Under the arrangement, it is contemplated that over the period of an Investor's involvement there will be assessable income derived by way of distributions of the net income of a Fund and net capital gains. As, the allowable interest on each of an Investment Loan and an Interest Loan will be 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.

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.

Subdivisions 328-F and 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 the choice to become such a taxpayer for that year.

26. 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 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 prepaid interest charges on the Investment Loan and Interest Loan allowable under section 8-1 of the ITAA 1997 are in relation to a prepayment of loan interest for a period that is 12 months or less. Paragraph 82KZL(2)(a) 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 five years for an Investment Loan and five years for an Interest Loan).

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 a Fund, including the financing and management arrangements.

30. Exception 1, as contained in subsection 82KZME(5), applies to exclude the interest allowable under section 8-1 of the ITAA 1997 incurred on borrowings under the Investment Loan and the Interest Loan, from the operation of section 82KZMF as:

- the documents and facts described in the arrangement at paragraphs 11 to 13 establish that Investors have fixed entitlements to all of the income and capital of an

Equity Trust and the Cash Trust. Therefore, the prepaid interest allowable under section 8-1 is incurred in respect of money borrowed to acquire units in a widely held trust as described in subparagraph 82KZME(5)(b)(iii);

- the Investor can reasonably expect to obtain 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 arrangement 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 a deductible interest prepayment under an Investment Loan and an Interest Loan is not longer 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 allowable under section 8-1 of the ITAA 1997 incurred under an Investment Loan and an Interest Loan.

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

34. Sections 82KZMA and 82KZMD set the amount and timing of deductions for expenditure for a taxpayer (other than an STS taxpayer for the year of income) 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 Investors, the deduction for prepaid interest on the Investment Loan and the Interest Loan will be apportioned over the relevant interest payment period.

Section 110-25 and Division 134 of the ITAA 1997: Cost base of the Put Option

37. If the Investor exercises the Put Option and transfers title to their units in the Fund to the Bank any gain or loss on exercise of the Put Option is disregarded. The Investor will add the cost base of the Put Option to the cost base of the units in the Fund disposed of to the Bank (subsection 134-1(1), item 2 of the ITAA 1997).

38. If the Investor does not exercise the Put Option, the Put Premium will form the cost base of the Put Option under subsection 110-25(2). The Investor will make a capital loss, at the time the Put Option expires, equal to the cost base of the Put Option (CGT Event C2, paragraph 104-25 (1) (c) of the ITAA 1997).

Section 25-25 of the ITAA 1997: Establishment Fee

39. The Establishment Fee, if applicable, incurred by an Investor upon successful application for an Investment Loan will be an allowable deduction pursuant to section 25-25. The Establishment Fee will be deductible over the period of the Investment Loan.

Part IVA of the ITAA 1936

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

Detailed contents list

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

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Commissioner of Taxation

12 May 2004

Previous draft:

Not previously issued in draft form

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

- financial products
- interest expense
- interest income
- prepaid expenses
- product rulings
- public rulings
- taxation administration

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 25-25
- ITAA 1997 104-10
- ITAA 1997 104-25
- ITAA 1997 104-25(1)(c)
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