



***PR 2004/69 - Income tax: tax consequences of investing in ISH Series UBS Instalment Warrants 2004 Product Disclosure Statement - 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 *26 May 2004*



## Product Ruling

### Income tax: tax consequences of investing in ISH Series UBS Instalment Warrants 2004 Product Disclosure Statement – cash applicants and on-market purchasers

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Potential participants may wish to refer to the ATO's website at [www.ato.gov.au](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 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 Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products 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 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

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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 persons, who takes part in the arrangement to which this Ruling relates. In this Ruling, the arrangement is the acquisition of a UBS Moderately Geared 'ISH' Series Instalment Warrant ('UBS ISH Instalment(s)') which provides an investment in securities that are listed for quotation on the Australian Stock Exchange ('ASX'), and a put option using a loan made by UBS AG, Australia Branch ('UBS').

### Tax law(s)

2. 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);
- subsection 110-45(3) (ITAA 1997);
- section 112-35 (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**

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below, through Cash Applications or secondary market purchases, on or after the date this Ruling is made. 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'.

4. This Ruling does not apply to Shareholder or Instalment Holder Applicants. Details of these types of applications are set out in the Product Disclosure Statement.

**Qualifications**

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**Date of effect**

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6. This Ruling applies prospectively from 26 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).

7. 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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8. This Product Ruling is withdrawn and ceases to have effect after 22 November 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

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

- application for Product Ruling dated 14 April 2004 received from Blake Dawson Waldron on behalf of UBS;
- Product Disclosure Statement for the UBS Instalment (the 'Product Disclosure Statement' or 'PDS'), prepared and issued by UBS, dated 11 March 2004;
- UBS Instalment Deed (the 'Instalment Deed') dated 4 November 2002 and executed by UBS, as Issuer, and UBS Nominees Pty Ltd ('Nominees'), as Security Trustee, as amended by the Supplemental Deed dated 11 March 2004;
- UBS Instalment Nominee Deed (the 'Nominee Deed') to be executed by Nominees (as Security Trustee), dated 11 March 2004; and
- UBS Instalment Loan Agreement (the 'Loan Agreement'), dated 11 March 2004.

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

11. On acceptance of a Holder's application for a UBS ISH Instalment, the Holder will enter into the Loan Agreement with UBS, appoint Nominees to act as its nominee on the terms of the Nominee Deed and will accept the UBS ISH Instalments on the terms and conditions set out in the Instalment Deed. Holders can also purchase UBS ISH Instalments once they are listed on the ASX.

12. UBS ISH Instalments are a moderately geared product that allows Holders to gain exposure to price movements and dividends or distributions from shares, units or stapled securities without paying the full price of the shares, units or stapled securities upfront. The gearing is the result of a Loan provided by UBS to Holders to fully or partly fund the investment in the securities. Where the investment includes a stapled security, the stapled security is comprised of share/s and unit/s that are jointly listed for quotation on the ASX. The Loan amount provided by UBS is fixed for each Interest Period and for the Interest Period as at the date of the PDS is specified in the PDS. The gearing levels for UBS ISH Instalments are as specified in the PDS and are expected to be in excess of 40% but not more than 70% based on the market price of the Underlying Parcel (see paragraph 13(b)) as at the date the Loan amount is fixed for the purposes of applying for ASX approval for admission to trading status or for each Reset Date.

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

- (a) the UBS ISH Instalment involves the Holder acquiring shares, units or stapled securities (via Nominees), acquiring a put option ('Put Option') and taking a limited recourse loan for up to four years (the 'Loan') from UBS;
- (b) the Holder can choose to invest in one or more of the securities listed in the PDS. Each share, unit or stapled security comprises one 'Underlying Parcel' for a UBS Instalment. In some instances, the Underlying Parcel will include Accretions (as defined in the PDS) conferred in respect of that security. The amount of the Loan provided to fund the purchase of each Underlying Parcel will be fixed by the Issuer on inception based on the then market value of the share, unit or stapled security and in relation to UBS ISH Instalments, the Loan amount will be reset under the loan reset facility at the end of each interest period (on each Reset Date) based on the then market value of the security;
- (c) repayment of the Loan will be secured by a mortgage over the Underlying Parcel which will be held by the Security Trustee on trust for the Holder (the 'Mortgaged Property'). Each trust and each Underlying Parcel to which it relates will be kept as a separate trust and there will be no pooling of interests or property to which the trust relates;

- (d) the Loan is provided on a limited recourse basis such that UBS's right to repayment of principal is limited to the amount which it can obtain by enforcing its rights in respect of the Mortgaged Property. UBS is entitled to exercise its security interest in respect of some or all of the Mortgaged Property in case of any event of default by the Holder, such as a failure to pay interest and borrow fees (if any) due on Cash Application or on each Reset Date;
- (e) the UBS ISH Instalment is open to initial investment by three types of investors one of which is Cash Applicants. They will also be listed on the ASX so that investors may participate by purchasing UBS ISH Instalments on the secondary market;
- (f) a Cash Applicant is a person who has acquired the UBS ISH Instalment by submitting a Cash Application Form and making the first payment in cash. Where the then security price is greater than the Loan amount, the entire Loan amount and part of the first payment will be applied towards the acquisition of the securities comprising the Underlying Parcel. Another part of the first payment will be used to prepay interest for the current interest period and the balance, if any, will relate to any borrow fees (see paragraph 13(i)) and taxes. Where the Loan amount is greater than the then security price, part of the Loan amount will be applied towards the purchase of the securities comprising the Underlying Parcel and the remainder of the Loan, together with the first payment contributed by the Cash Applicant, will be used to prepay interest for the current interest period and to pay for any borrow fees and taxes. UBS will confirm the allocation of the first payment by issuing a confirmation to successful applicants;
- (g) interest on the Loan is payable in advance for each interest period (the 'Interest Amount'). Interest is therefore payable at the commencement of the Loan and on each Reset Date. On transfer of a UBS ISH Instalment on the secondary market, the seller will receive a pro rata refund of previously prepaid interest from UBS. Furthermore, where UBS brings forward the Final Maturity Date or fixes an Additional Reset Date, UBS will refund a pro-rata portion of the interest prepaid to the Holder (less any costs incurred by UBS for the early termination of its funding and hedging arrangements). In all other circumstances, interest prepaid is non-refundable;

- (h) the interest rate charged on the Loan will be fixed for each interest period. However, as the UBS ISH Instalment has a loan reset facility, the Interest Rate may vary between interest periods as it will be reset on each Reset Date to reflect changes in market interest rates. The Interest Rate charged will reflect UBS's cost of funds in providing the Loan plus its profit margin;
- (i) a borrow fee ('Borrow Fee') will also be payable on application by Cash Applicants and on each Reset Date by Holders of UBS ISH Instalments whose Loan is reset. The Borrow Fee will comprise one or both of two components, a fee for the grant of the Put Option and an amount which is paid for acquiring the Loan from UBS or paid to UBS for resetting the Loan amount. Borrow Fees are generally not payable for secondary market sales and purchases, although part of the price paid by a secondary market purchaser will be attributed to the purchase of the seller's Put Option;
- (j) when UBS grants the Holder a Put Option over the Underlying Parcel on acceptance of an application or on a Reset Date, all or part of the Borrow Fee charged will be allocated to the Put Option purchase price payable by the Holder in consideration for the grant (the breakdown of the Borrow Fee between the Put Option Purchase Price and payment for acquiring the Loan from UBS or payment to UBS for resetting the Loan amount will be notified to Holders in a confirmation issued by UBS). The Put Option, exercisable at any time before the closing time on the earlier of the next Reset Date or the Final Maturity Date, allows the Holder to sell the Underlying Parcel to UBS for a price equal to the outstanding Loan amount at that date;
- (k) the Loan provided by UBS is a 'limited recourse' loan for up to four years. Under the terms of the Loan Agreement, UBS's ability to recover the principal amount of the Loan will be limited to either:
  - (i) if the Put Option is exercised by the Holder - the amount payable to the Holder under the Put Option; or
  - (ii) if the Put Option is not exercised by the Holder - the amount recoverable by UBS on the enforcement of its rights in respect of the Mortgaged Property;
- (l) in all other respects (for example, payment of interest, Borrow Fees and taxes), UBS's recourse against a Holder will not be limited;



- (m) during the period of the Loan, Holders will be entitled to all dividends and distributions paid on the securities comprising the Underlying Parcel. The Holder may also direct the Security Trustee to attend and vote at shareholders' meetings of the Company in which the shares are held;
- (n) UBS ISH Instalments are traded on the secondary market. A seller on the ASX will dispose of its interest in the securities comprising the Underlying Parcel and any Put Option to the purchaser. The purchaser will drawdown a new Loan from UBS on the trade date and will prepay interest for the period beginning on the trade date up until the next Reset Date or maturity date (as applicable). The amount borrowed from UBS will be paid by the purchaser to the seller, who will use this amount to repay their outstanding Loan balance, and UBS will use the interest paid by the purchaser to refund to the seller a pro rata portion of interest previously prepaid;
- (o) as UBS ISH Instalments have a loan reset facility, Reset Dates occur annually up until the Final Maturity Date. On each Reset Date, UBS can elect to terminate the arrangement or reset the Loan amount. Where the reset option is chosen, UBS will set a new Loan amount for the new interest period which will be based on the market price of the securities comprising the Underlying Parcel around the time of the Reset Date, and will also specify a new Interest Rate and Borrow Fees applicable to the new interest period. The new Loan amount may be more or less than the Loan amount for the immediately preceding interest period. UBS may also, in certain specified circumstances, fix an Additional Reset Date. In such circumstances, UBS may reset the Holder's Loan amount, Interest Rate and the amount of any Borrow Fees;
- (p) where the Loan is reset, the Holder will have a number of options:
  - (i) exercise the UBS ISH Instalment, pay the outstanding Loan amount (the 'Completion Payment') to UBS and have the securities comprising the Underlying Parcel transferred to it;

- (ii) maintain its holding of UBS ISH Instalments by electing the Cash Rollover Option. If this election is made and the Loan amount increases as a result of this reset, the additional Loan proceeds, after deducting interest cost, Borrow Fees (if applicable) and taxes (collectively referred to as the 'Reset Costs'), will be paid to the Holder. If the Loan amount is reduced as a result of the reset, or the amount of the increase is not sufficient to cover the reset costs, the Holder will be required to pay to UBS the amount of the shortfall. The Loan will then continue until the next Reset Date;
- (iii) do nothing and be deemed to have elected the Non-Cash Rollover Option. If the Loan amount is increased on reset, the additional Loan proceeds will, after application against reset costs, be applied to purchase for the Holder further UBS ISH Instalments in the same series on the secondary market. If the Loan amount is reduced on reset or does not increase enough to cover the reset costs, the Loan will be repayable on a number of UBS ISH Instalments and UBS will enforce its security interest in respect of the Underlying Parcels relating to those UBS ISH Instalments. UBS will sell those securities and apply the proceeds against the costs of the sale, the reset costs and in repayment of the Loans for the terminated Instalments;
- (iv) sell the UBS ISH Instalments on the secondary market prior to the Reset Date;
- (v) where the market value of the Underlying Parcel at the closing time on the Reset Date is less than or equal to the Holder's outstanding Loan amount, exercise the Put Option and transfer its interest in the Underlying Parcel to UBS for an amount equal to the outstanding Loan amount. UBS will apply the amount payable to the Holder in respect of such transfer in satisfaction of the Holder's obligation to repay the Loan; or
- (vi) if UBS offers a new series of UBS ISH Instalments over the securities comprising the Underlying Parcel, roll over their investment from the expiring or resetting series to the new series as an Instalment Holder Applicant;

- (q) at the Final Maturity Date, or at any time prior to that date, Holders may exercise their UBS ISH Instalments by giving to UBS a completion notice and paying to UBS the Completion Payment. The securities comprising the Underlying Parcel will then be transferred to the Holder free of any security interest. Alternatively, where the market value of the Underlying Parcel at maturity is less than the outstanding Loan amount, the Holder may exercise the Put Option and transfer its interest in the Underlying Parcel to UBS for the outstanding Loan amount. UBS will apply the amount payable to the Holder in respect of such transfer in satisfaction of the Holder's obligation to repay the Loan;
- (r) if, at the Final Maturity Date, no completion notice is given by the Holder and the Put Option is not exercised, UBS will enforce its security interest and exercise its power of sale. The proceeds of sale will be applied towards repayment of the outstanding balance of the Loan and any costs incurred by UBS or the Security Trustee in relation to the sale. Any remaining proceeds will be paid to the Holder. Due to the limited recourse nature of the Loan, if the sale proceeds are insufficient to repay the Loan in full, the Holder will not be required to pay the shortfall;
- (s) UBS may, in certain specified circumstances, fix an Early Final Maturity Date. In such circumstances, the Final Maturity Date will be brought forward and the Holder's UBS ISH Instalment will terminate on the Early Final Maturity Date; and
- (t) UBS may, in its absolute discretion, elect to bring forward the Final Maturity Date for the UBS ISH Instalments relating to securities in a particular entity if the Closing Price of an Underlying Parcel for those UBS ISH Instalments falls below a set level (the 'Barrier Level' as set out in the PDS) applicable to those UBS ISH Instalments at that time. As an alternative to declaring an Early Final Maturity Date, UBS may nominate an Additional Reset Date.

### **The Participants**

- 14. UBS is the Issuer of the UBS ISH Instalment and also the provider of the Loans to Holders to fund the acquisition of the Underlying Parcel.
- 15. UBS Nominees Pty Ltd holds the legal title to the Underlying Parcel as nominee for each Holder.
- 16. The Holders may be individuals, companies, trusts or superannuation funds.

## Ruling

17. Subject to paragraph 18 of this Ruling
- (a) the Interest Amount paid by a Holder under the Loan Agreement is deductible to the Holder under section 8-1 of the ITAA 1997;
  - (b) the Interest Amount paid by a secondary market purchaser of the UBS ISH Instalment in respect of the period from the contract date for transfer of the UBS ISH Instalment (the Loan drawdown date) until the next Reset Date or Final Maturity Date (as applicable) is deductible under section 8-1 of the ITAA 1997;
  - (c) 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;
  - (d) 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;
  - (e) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for an Interest Amount incurred under the UBS ISH Instalment;
  - (f) section 82KZM of the ITAA 1936 will not apply to deny the Holder immediate deductibility for the Interest Amount allowable under section 8-1 of the ITAA 1997 under the UBS ISH Instalment where at least one of the following applies for the year of income;
    - (i) the Holder is a Simplified Tax System ('STS') taxpayer; or
    - (ii) the Holder is an individual who does not incur the Interest Amount in carrying on a business;
  - (g) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the Interest Amount incurred under the UBS ISH 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;
  - (h) the portion of the Borrow Fee that is paid for acquiring the Loan from UBS or resetting the Loan amount by UBS will be deductible to a Holder under section 25-25 of the ITAA 1997;
  - (i) the part of the Borrow Fee which is applicable to the purchase of the Holder's Put Option is included in the cost base of the Underlying Parcel under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised;

- (j) the part of the Borrow Fee which is applicable to the purchase of the Holder's Put Option is included in the cost base of the Holder's Put Option under section 110-25 of the ITAA 1997 if the Holder's Put Option is not exercised;
- (k) for secondary market purchasers the cost base of the Put Option will be:
  - (i) if the market value of the security 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 UBS ISH Instalment plus the purchaser's Loan amount less the sum of the market value of the security and the Interest Amount prepaid by the purchaser on the Loan amount; and
  - (ii) if the market value of the security 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 UBS ISH 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;
- (l) for secondary market purchasers the amount determined under paragraph 17(k) 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;
- (m) for secondary market purchasers the amount determined under paragraph 17(k) above 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;
- (n) a CGT event will occur under section 104-25 of the ITAA 1997 on a Reset Date or Final Maturity Date if the Put Option is not exercised and lapses. The capital proceeds received on lapsing of the Put Option will be nil;
- (o) the date of acquisition of the beneficial interest in the Underlying Parcel and any Put Option under section 109-5 ITAA 1997 is, in the case of a Cash Applicant, the date of acceptance of the application, or in the case of a secondary market purchaser of UBS ISH Instalments, the contract date for transfer of the UBS ISH Instalment;

- (p) 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 UBS ISH Instalment pursuant to subsection 104-10(7) of the ITAA 1997;
- (q) a CGT event will arise under section 104-10 of the ITAA 1997 to the Holder where the Completion Payment is not made and the Underlying Parcel is sold by UBS 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 in accordance with the provisions of subsection 110-45(3) of the ITAA 1997. The capital proceeds will be the value received by UBS on disposal of the Underlying Parcel;
- (r) any capital gain realised by a Holder on sale of an Underlying Parcel received pursuant to completion of a UBS ISH Instalment, will be treated as a discount capital gain pursuant to section 115-5 of the ITAA 1997 where the Holder is an individual, a complying superannuation entity, or a trust and has held the UBS ISH Instalment for at least 12 months;
- (s) Holders (and not the Security Trustee) are assessable under section 97 of the ITAA 1936 on all of the income derived from the Underlying Parcel while the Underlying Parcel is the subject of the separate Trust; and
- (t) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to a Holder in respect of the UBS ISH Instalment.

## **Assumptions**

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18. This Ruling is made on the basis of the following assumptions:
- (a) all of the Holders are Australian residents for taxation purposes;
  - (b) at all times during the arrangement, where the stapled security includes a unit in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
  - (c) 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;

- (d) 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;
- (e) the dominant purpose of a Holder in entering the arrangement is to derive assessable income from their investment in the UBS ISH Instalments;
- (f) the arrangement will be executed in the manner described in the 'Arrangement' section of this Ruling;
- (g) all dealings by the Holders and UBS 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

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### Section 8-1 of the ITAA 1997

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

20. No part of the interest charged by UBS under the Loan Agreement is a capital protection fee as the Put Option provides the capital protection under the arrangement. The Interest Amounts incurred by a Holder in relation to monies borrowed from UBS under the Loan Agreement will therefore 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 UBS ISH Instalment by Cash Application or by purchase on the ASX.

### Section 51AAA of the ITAA 1936

21. By acquiring the UBS ISH Instalment it is contemplated that a Holder will derive assessable income by the receipt of dividends, trust distributions 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 a Holder acquiring the UBS ISH 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) 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, and not to the period of the Loan, which is up to 4 years for UBS ISH Instalments.

***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 the UBS ISH Instalments, including the financing, purchase and holding of securities and disposal arrangements.

29. Under the arrangement, when the Holder acquires UBS ISH Instalments, they acquire beneficial ownership of the security comprising the Underlying Parcel.

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

- (a) the prepaid interest expenditure under the UBS ISH Instalments is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX or units in a trust as described in subparagraph 82KZME(5)(b)(iii);
- (b) the Holder can reasonably be expected to obtain dividends 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 UBS ISH Instalments are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 30 to 35.

***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:

- (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.

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 UBS ISH 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 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 Holders, the deduction for prepaid interest on the UBS ISH Instalment will be apportioned over the relevant interest payment period.

**Borrow Fee**

37. Part of the Borrow Fee is a payment for the purchase of the Put Option and the balance represents a payment for acquiring the Loan from UBS or a payment to UBS for resetting the Loan amount. This payment for acquiring or resetting the Loan is deductible under section 25-25 of the ITAA 1997 over the period of the Loan.

38. In the arrangement, UBS has granted to the Holder a Put Option. Part of the Borrow Fee paid by the Cash Applicant on Cash Application or the Holder on a Reset Date is allocated to the consideration for that Put Option (being the Put Option Purchase Price). Payment of the Put Option Purchase Price ensures that the Holder is protected from personal liability to repay the principal of the Loan if the market value of the Underlying Parcel falls below the outstanding Loan amount. In effect, the Put Option ensures that UBS will acquire the Underlying Parcel in full satisfaction of the Loan if the Underlying Parcel has fallen in value below the amount borrowed.

39. The Put Option Purchase Price is not deductible as it is incurred for a purpose other than to service or maintain the borrowed funds. The fee is capital in nature, being paid to acquire an asset, namely, the Put Option.

**Sections 110-25, 112-35 and 134-1 of the ITAA 1997***Cost base of Put Option – Cash Applicant and Holder on Reset Date*

40. If the Put Option is not exercised, that portion of the Borrow Fee paid by a Cash Applicant or a Holder on a Reset Date that is attributable to the purchase of the Put Option will be included in the Cash Applicant's or Holder's cost base of the Put Option under section 110-25.

41. If the Put Option is exercised, that portion of the Borrow Fee that is attributable to the purchase of the Put Option will be included in the Cash Applicant's or Holder's cost base of the security comprising the Underlying Parcel under section 134-1.

*Cost base of Put Option – secondary market purchaser*

42. If the market value of the security 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, is the price of the UBS ISH Instalment plus the purchaser's Loan amount less the sum of the market value of the security and the interest prepaid by the purchaser on the Loan amount.

43. If the market value of the security 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 UBS ISH 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.

**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 a secondary market purchaser, the contract date for the transfer of the UBS ISH Instalment.

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

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 and the UBS Instalment or the Underlying Parcel is sold to UBS or to a third party. 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 the provisions of subsection 110-45(3) of the ITAA 1997. The capital proceeds will be the value received by UBS on disposal of the Mortgaged Property.

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

47. If the Put Option lapses on a Reset Date or Final Maturity Date a CGT event C2 will occur for the Holder. The capital proceeds received in respect of this event will be nil.

**Section 115-5 of the ITAA 1997***Discount on capital gains*

48. Division 115 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 UBS Instalment or on the sale of an Underlying Parcel received pursuant to the completion of a UBS ISH 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 UBS ISH Instalment for at least 12 months.

**Section 97 of the ITAA 1936**

49. The Holders are presently entitled to all of the income derived from the Underlying Parcel. Therefore, section 97 will apply to assess the Holder 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**

50. Provided that the arrangement ruled on is entered into and carried out as described it would be accepted as an ordinary commercial transaction and Part IVA will not apply.

**Detailed contents list**

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**Commissioner of Taxation**

26 May 2004

<i>Previous draft:</i>	- ITAA 1936 82KZL(2)(a)
Not previously issued in draft form	- ITAA 1936 82KZM
	- ITAA 1936 82KZMA
<i>Related Rulings/Determinations:</i>	- ITAA 1936 82KZMD
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1936 82KZME
TR 95/33; TR 97/16; TD 93/34	- ITAA 1936 82KZME(4)
	- ITAA 1936 82KZME(5)
	- ITAA 1936 82KZME(5)(b)(iii)
<i>Legislative references:</i>	- ITAA 1936 82KZMF
- TAA 1953 Pt IVAAA	- ITAA 1936 Pt III Div 3 Subdiv H
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