



PR 2004/74 - Income tax: tax consequences of investing in Westpac 'SWA' Series Self-Funding Instalments 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 *9 June 2004*



Product Ruling

Income tax: tax consequences of investing in Westpac 'SWA' Series Self-Funding Instalments 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 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

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 'SWA' Series Self-Funding Instalments ('Westpac SWA Instalments') under the Product Disclosure Statement dated 16 February 2004 which provide an investment in shares listed on the Australian Stock Exchange ('ASX') and/or units in certain 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.

Tax law(s)

3. The tax laws dealt with in this Ruling are:
 - section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 25-25 (ITAA 1997);
 - section 104-10 (ITAA 1997);
 - section 104-25 (ITAA 1997);
 - section 109-5 (ITAA 1997);
 - subsection 110-25 (ITAA 1997);
 - subsection 110-45(3) (ITAA 1997);
 - section 112-35 (ITAA 1997);
 - section 115-5 (ITAA 1997);
 - section 116-20 (ITAA 1997);
 - section 134-1 (ITAA 1997);
 - section 51AAA of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 82KL (ITAA 1936);
 - section 82KZM (ITAA 1936);

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

Class of persons

4. The class of persons to whom this Ruling applies is those who enter into the arrangement described 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 or Rollover Applications. 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

9. This Ruling applies prospectively from 9 June 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

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. 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

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 13 April 2004 received from Allens Arthur Robinson on behalf of Westpac Banking Corporation;
- Deed Poll – Declaration of Trust dated 18 December 2003 executed by the Security Trustee;
- Supplementary Deed Poll – Declaration of Trust dated 13 February 2004 executed by the Security Trustee;
- Deed Poll – Warrant Terms dated 16 February 2004 executed by Westpac;

- Product Disclosure Statement for Westpac SWA Instalments dated 16 February 2004 (which includes the terms of the Loan Agreement);
- Supplementary Product Disclosure Statement for Westpac Self-Funding Instalments dated 2 March 2004; and
- Draft Supplementary Product Disclosure Statement for Westpac Self-Funding Instalments received 2 June 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 SWA Instalments are a leveraged investment under which a Holder acquires a beneficial interest in shares and/or stapled securities listed on the ASX and/or units in certain listed trusts ('Security') using a limited recourse Loan made by Westpac. Where the Security includes a stapled security, the stapled security comprises shares and/or units that are jointly listed for quotation on the ASX. The Security, together with any Accretions, is referred to as the 'Underlying Parcel';
- (b) the Loan Amount is set at the beginning of the Offer Period. The Product Disclosure Statement specifies the Loan Amount for Westpac SWA Instalments over each Security;
- (c) the Loan Amount is reduced during the term of the Westpac SWA Instalment by the amount of any Dividends in respect of which the Underlying Securities trade ex-entitlement. All such Dividends are applied under the Order of Payment in reduction of the Loan Amount;
- (d) where a Dividend has an ex-entitlement date during the term of the Loan, Westpac will pay to the Security Trustee the portion of the prepaid Interest Amount that is referable to the amount of the Dividend for the period from and including the ex-entitlement date until and including the next Annual Interest Date or Completion Date as applicable ('Reimbursement Amount'). Under the Loan Agreement, the Holder directs the Security Trustee and Westpac to apply the Reimbursement Amount to reduce the Loan Amount;
- (e) if a Holder fails to quote a TFN or ABN to Westpac or the Security Trustee by the time required under the Taxation Administration Act 1953, the amount that the Security Trustee is obliged or authorised to withhold

and pay to the Commissioner under that Act in respect of the Dividend (the 'TFN/ABN Amount') becomes a debt immediately payable by the Holder to Westpac. If the TFN/ABN Amount is not paid, Westpac may exercise its Security Interest over the Underlying Parcel;

- (f) the Interest Amount is payable on Cash Application (as a component of the First Payment) and on each Annual Interest Date. The Interest Amount is payable in advance for the period to the next Annual Interest Date (or, in respect of the final Interest Amount, the period to the Completion Payment Date). The Interest Amount is drawn down under the Loan on each Annual Interest Date;
- (g) 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;
- (h) Holders may repay the Loan on an Annual Interest 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;
- (i) 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;
- (j) Westpac SWA Instalments incorporate a Put Option which entitles the Holder to sell the Underlying Parcel to Westpac for the greater of the Completion Payment and the market value of the Underlying Parcel on the Completion Payment Date. The cost of the Put Option is the Put Option Fee, which is payable on Application;
- (k) Westpac SWA 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 SWA Instalment by way of Cash

Application. A Cash Application must be accompanied by the First Payment. The First Payment consists of:

- the non-refundable Capital Component which is used to fund the acquisition of the Underlying Parcel by the Security Trustee;
- the Interest Amount paid in advance on the Loan;
- the non-refundable Put Option Fee which is the cost of Westpac providing the Holder with the Put Option; and
- non-refundable 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;

- (l) Westpac SWA Instalments are also listed on the ASX so that investors may participate by purchasing Westpac SWA Instalments on market;
- (m) where a Westpac SWA Instalment is purchased on the ASX, the purchaser acquires the Westpac SWA 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 Annual Interest Date (or Completion Payment Date), refund part of the interest prepaid by the seller and discharge the seller's Loan; and
- (n) at the Completion Payment Date, 30 June 2009, the following options are available to Holders of Westpac SWA 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;
 - if offered, apply to rollover the Westpac SWA Instalments to a future series of Westpac Instalments; or

- if Holders do nothing, 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.

Participants

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

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

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

Ruling

18. Subject to the Assumptions in paragraph 19 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) 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 SWA 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 SWA 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 expenditure in carrying on a business;
- (f) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to determine the amount and timing of deductions for the Interest Amount incurred under a Westpac SWA 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) the Borrowing Fee (if any) charged on Cash Application 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 Put Option is not exercised, the Put Option Fee charged on Cash Application will be included in the Holder's cost base of the Put Option under section 110-25 of the ITAA 1997;
- (i) if the Put Option is exercised, the Put Option Fee charged on Cash Application will be included under section 134-1 of the ITAA 1997 in the Holder's cost base of the Underlying Parcel acquired;
- (j) for on-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 Westpac SWA 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 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 Westpac SWA 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, if the Put Option is exercised, 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, if the Put Option is not exercised, 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;
- (m) a CGT event will occur under section 104-25 of the ITAA 1997 on the 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;
- (n) under section 109-5 of the ITAA 1997, the date of acquisition of the beneficial interest in the Underlying Parcel and the Put Option is, in the case of a Cash Applicant, the date of acceptance of the Cash Application, or in the case of an on-market purchaser of Westpac SWA Instalments, the contract date for transfer of the Westpac SWA 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 SWA Instalment pursuant to subsection 104-10(7);
- (p) a CGT event will arise under section 104-10 of the ITAA 1997 to the Holder where the Completion Payment or a TFN/ABN Amount is not paid 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 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;
- (q) any capital gain realised by a Holder on sale of the Westpac SWA Instalment or on sale of an Underlying Parcel received pursuant to completion of a Westpac SWA 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 SWA Instalment for at least 12 months;

- (r) the 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 including Dividends and the Reimbursement Amount which are applied under the Order of Payment in reduction of the Loan Amount; 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 SWA Instalment.

Assumptions

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 or 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 SWA 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 cost (or interest paid) of 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).

21. 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 SWA Instalment by 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

22. By acquiring the Westpac SWA 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 SWA Instalment.

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 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

25. 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.

26. 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

27. 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, which is approximately 5 years for Westpac SWA Instalments.

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

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

29. For the purposes of section 82KZME, 'agreements' are broadly defined to include an entire arrangement of which a contract may form part. Under subsection 82KZME(4), the relevant 'agreement' is all the contractual arrangements and activities associated with the participation in a Westpac SWA Instalment, including the financing, the purchase of a Security, the holding of a Security and the disposal arrangements.

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

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

- (a) the prepaid interest expenditure under the Westpac SWA Instalments 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 SWA Instalments are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 32 to 37.

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

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

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

33. The expenditure must not be excluded expenditure and must be incurred otherwise than in carrying on a business. Section 82KZM applies if the eligible service period for the expenditure is longer than 12 months, or the eligible service period for the expenditure is 12 months or shorter but ends after the last day of the year of income after the one in which the expenditure was incurred and the expenditure would otherwise be immediately deductible under section 8-1 of the ITAA 1997.

34. As the eligible service period in relation to the deductible interest for Westpac SWA 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

35. 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.

36. 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.

37. For these taxpayers, the deduction for prepaid interest on the Westpac SWA Instalment will be apportioned over the relevant interest payment period.

Borrowing Fee

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

Cost base of Put Option – Cash Applicant

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

40. If the Put Option is exercised, the Put Option Fee will be included in the cost base of the Underlying Parcel under section 134-1 of the ITAA 1997.

Cost base of the Put Option – on-market purchasers

41. 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 SWA 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.

42. 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 SWA 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.

43. 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.

44. 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 104-25 of the ITAA 1997

45. Where, at the Maturity Date, the Holder makes the Completion Payment, the Put Option will expire. The expiration of the Put Option gives rise to CGT event C2 (paragraph 104-25(1)(c) of the ITAA 1997). The capital proceeds received on the lapsing of the Put Option will be nil.

Section 109-5 of the ITAA 1997

Acquisition of a CGT asset

46. 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 SWA Instalment.

Subsection 104-10(7) of the ITAA 1997

No CGT event when Completion Payment made

47. 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

48. A CGT event will arise to the Holder if the Holder does not pay the Completion Payment or a TFN/ABN Amount 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 the provisions of 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*

49. 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 Westpac SWA Instalment or on the sale of the Underlying Parcel received pursuant to the completion of a Westpac SWA 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 SWA Instalment for at least 12 months.

Section 97 of the ITAA 1936

50. The Holders are presently entitled to all of the income derived from the Underlying Parcel including Dividends and the Reimbursement Amount which are applied under the Order of Payment in reduction of the Loan Amount. 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

51. 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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Related Rulings/Determinations:

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TR95/33; TR 97/16; TD 93/94

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- ITAA 1936 82KZL(1)
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