



# ***PR 2004/92 - Income tax: tax consequences of investing in Macquarie Hot Instalment Warrants IMD Series 2004 Product Disclosure Statement - cash applicants and on-market purchasers***

 This cover sheet is provided for information only. It does not form part of *PR 2004/92 - Income tax: tax consequences of investing in Macquarie Hot Instalment Warrants IMD Series 2004 Product Disclosure Statement - cash applicants and on-market purchasers*

 This document has changed over time. This is a consolidated version of the ruling which was published on *15 September 2004*



## Product Ruling

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

Contents	Para
<b>What this Product Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>9</b>
<b>Withdrawal</b>	<b>11</b>
<b>Arrangement</b>	<b>12</b>
<b>Participants</b>	<b>17</b>
<b>Ruling</b>	<b>20</b>
<b>Assumptions</b>	<b>22</b>
<b>Explanation</b>	<b>22</b>
<b>Detailed contents list</b>	<b>56</b>

### **Preamble**

*The number, subject heading, **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement and Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

## **No guarantee of commercial success**

The Tax Office **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products and how the product fits an existing portfolio. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants should be aware that the Tax Office will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

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.

## 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 a Macquarie Hot Instalment Warrant IMD Series under the Product Disclosure Statement dated 18 May 2004 ('Macquarie IMD Instalments') which provides an investment in shares and units listed for quotation on the Australian Stock Exchange ('ASX') and a put option ('Holder's Put Option') using a loan made by Macquarie Bank Limited ('Macquarie').
2. This Ruling does not address the tax consequences of the Rollover Cashback that is provided as a cash payment.

### Tax law(s)

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

- section 82KZMD of the ITAA 1936;
- section 82KZME of the ITAA 1936;
- section 82KZMF of the ITAA 1936;
- section 97 of the ITAA 1936; and
- Part IVA of the 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 apply to Shareholder Applicants and Rollover Applicants. Details of these types of applications are set out 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.

8. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration  
Intellectual Property Branch  
Department of Communications, Information Technology and  
the Arts  
GPO Box 2154  
Canberra ACT 2601

or by e-mail: [commonwealth.copyright@dcita.gov.au](mailto:commonwealth.copyright@dcita.gov.au)

## Date of effect

---

9. This Ruling applies prospectively from 15 September 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 19 May 2006. 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 18 June 2004 received from Mallesons Stephen Jaques on behalf of Macquarie;
- Macquarie Instalments Trust Deed dated 28 February 2001, as amended by the Supplemental Deed of Amendment on 15 February 2002, Second Supplemental Deed of Amendment on 15 April 2002, Third Supplemental Deed of Amendment on 11 April 2003 and Fourth Supplemental Deed to that Trust Deed dated 18 May 2004 ('Trust Deed');
- Product Disclosure Statement for Macquarie IMC & IMD Series Instalments dated 18 May 2004 ('PDS'); and
- further information provided on 29 July 2004.

13. In this Ruling, unless otherwise defined, capitalised terms take their meaning as per the PDS.

14. Each Macquarie IMD Instalment is comprised of one Underlying Share which consists of one share, unit or stapled security. Where the Underlying Share includes a stapled security, the stapled security is comprised of share/s and unit/s that are jointly listed for quotation on the ASX. In some instances, Underlying Share will include Accretions conferred in respect of that share or unit. Any reference in this Ruling to shares and shareholders includes units and unitholders.

15. Macquarie IMD Instalments are a highly geared product that allows Holders to gain exposure to share price movements and dividends/trust income without paying the full price of the share. The gearing level is maintained within a range of approximately 70 - 95% of the underlying share price.

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

- (a) the Macquarie IMD Instalments involve the Holder acquiring the Underlying Share and a Holder's Put Option using a limited recourse loan from Macquarie. The term of the investment is up to 2 years;
- (b) the Macquarie IMD Instalment may be initially acquired through three types of applications, one of which is a Cash Application. As Macquarie IMD Instalments are listed on the ASX investors may also purchase them on-market;
- (c) on acceptance of a Holder's application for a Macquarie IMD Instalment, the Holder will enter into the Loan Agreement with Macquarie, appoint Belike Nominees Pty Ltd to act as its nominee under the terms of the Trust Deed and will accept the Macquarie IMD Instalment on the terms and conditions set out in the Trust Deed;
- (d) under a Cash Application, the Cash Applicant pays the varying First Payment. Macquarie lends the Completion Payment amount (which is the current Loan Amount) to the Cash Applicant and takes a security interest over the Underlying Share. Proceeds of the Loan and the First Payment from the Cash Applicant are applied toward the purchase of the Underlying Share, prepayment of interest to Macquarie and the payment of borrowing fees to Macquarie. Macquarie buys the Underlying Share in the name of the Security Trustee. The Macquarie IMD Instalment is issued in the name of the Cash Applicant;
- (e) the Loan Amount provided to fund the purchase of each Underlying Share is fixed until the first Annual Reset Date. At the Annual Reset Date there is a review

- of the Loan Amount. Where the value of the Underlying Share has increased the Loan may increase and Holders may receive additional Macquarie IMD Instalments. Where the value of the Underlying Share has decreased (or has not increased by much) the Loan may be reduced and Holders may be required to make a payment to cover the decrease plus the Interest Amount and borrowing fees or risk some or all of their Macquarie IMD Instalments terminating;
- (f) repayment of the Loan will be secured by a mortgage over the Underlying Share which will be held by the Security Trustee as trustee for the Holder. Each trust and each Underlying Share 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;
  - (g) the Loan is provided on a limited recourse basis such that Macquarie's right to repayment of the Loan is limited to the amount it can obtain by enforcing its right in respect of the Mortgaged Property;
  - (h) the Interest Amount will be determined at the time of Cash Application for a Macquarie IMD Instalment, on the Annual Reset Date and on the drawdown of the Loan by an on-market purchaser. The Interest Amount is payable on Cash Application and thereafter on the Annual Reset Date;
  - (i) where the Macquarie IMD Instalments are purchased on-market, the purchaser acquires the Macquarie IMD Instalments on the same terms and conditions under which they were originally issued. In particular, the on-market purchaser will be offered and will accept a Loan from Macquarie upon the transfer of the Macquarie IMD Instalments from the previous owner to the on-market purchaser. The Loan provided by Macquarie will be equal to the previous owner's Loan and will be applied to discharge the previous owner's Loan and to prepay the Interest Amount on the newly acquired Loan;
  - (j) Holders can obtain the Underlying Share at any time before the Maturity Date by making the Completion Payment;
  - (k) the Completion Payment is equal to the Loan Amount on the date the Completion Payment is made;
  - (l) borrowing fees are payable at Cash Application and each Annual Reset Date by Holders. The borrowing fee will comprise two components, a fee for the grant of the Holder's Put Option and an amount which is paid for acquiring the Loan from Macquarie or for resetting the Loan Amount by Macquarie; and

- (m) at Maturity, the Holder has 4 options:
- (i) pay the Completion Payment:  
the Loan is repaid, the security interest is extinguished and the shares are delivered to a holding in the Holder's name;
  - (ii) exercise the Holder's Put Option:  
the shares are purchased by Macquarie at the higher of the Completion Payment or the market price and the proceeds are applied to repayment of the Loan (and any other Secured Moneys) with any residual paid to the Holder;
  - (iii) rollover:  
a rollover is equivalent to the Holder completing the expiring series by making the Completion Payment and then investing in the new series by way of a Shareholder Application. Under the rollover, the Underlying Share is not sold rather, the expiring warrant is cancelled and the Holder is allotted a Macquarie Instalment in the new series; or
  - (iv) do nothing:  
at Maturity if the Completion Payment is not made, and the Holder's Put Option is not exercised, the Underlying Share will be sold and any surplus from net proceeds after repayment of the Loan and costs will be paid to the Holder. If the sale proceeds are insufficient to repay the Loan, Macquarie has no recourse against the Holder to recover the shortfall.

## **Participants**

---

17. Macquarie is the Issuer of the Macquarie IMD Instalments. Macquarie is also the provider of the Loans to Holders to fund the acquisition of the Underlying Shares.
18. Belike Nominees Pty Ltd holds the legal title to the Underlying Share as Security Trustee and as trustee for each Holder.
19. The Holders may be individuals, companies, trusts or superannuation funds.

## Ruling

---

20. Subject to the assumptions listed in paragraph 21 of this Ruling:

- (a) section 8-1 of the ITAA 1997 will apply to allow a Holder a deduction for the Interest Amount charged under the Loan Agreement;
- (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 the Interest Amount incurred by a Holder under the Macquarie IMD Instalment;
- (e) section 82KZM of the ITAA 1936 will not apply to deny the Holder immediate deductibility of any part of the Interest Amount incurred by the Holder under the Macquarie IMD Instalment where at least one of the following applies for the year of income:
  - the Holder is an STS taxpayer; or
  - the Holder is an individual who does not incur the interest charge in carrying on a business;
- (f) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the Interest Amount incurred under the Macquarie IMD Instalment that is deductible to a Holder (other than an STS taxpayer for the year of income) who is not an individual and does not carry on a business;
- (g) the portion of the borrowing fee that is paid for acquiring the Loan from Macquarie or for resetting the Loan Amount by Macquarie will be deductible to the Holders under section 25-25 of the ITAA 1997 over the period of the Loan;
- (h) for Holders the part of the borrowing fee which is applicable to the purchase of the Holder's Put Option is included in the cost base of the Underlying Share under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised;

- (i) for Holders the part of the borrowing 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;
- (j) for on-market purchasers the cost base of the Holder's Put Option is calculated as follows:
- if the market value of the share at the time of purchase is greater than the Completion Payment (the Loan Amount) the cost base of the Holder's Put Option is the total consideration as determined by sections 110-25 and 112-35 of the ITAA 1997 (the price of the Macquarie IMD Instalment plus the Completion Payment) less the sum of the market value of the share and the interest prepaid on the newly acquired Loan; and
  - if the market value of the share at the time of purchase is less than the Completion Payment the cost base of the Holder's Put Option is the total consideration as determined by sections 110-25 and 112-35 of the ITAA 1997 (the price of the Macquarie IMD Instalment plus the Completion Payment) less the sum of the Completion Payment and the interest prepaid on the newly acquired Loan;
- (k) for on-market purchasers the amount determined under paragraph 20(j) will be included in the cost base of the Underlying Share under section 134-1 of the ITAA 1997 if the Holder's Put Option is exercised;
- (l) for on-market purchasers the amount determined under paragraph 20(j) will be 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;
- (m) for capital gains tax ('CGT') purposes, including for the purposes of the CGT discount, the date of acquisition of the Underlying Share under section 109-5 of the ITAA 1997 is the date on which Holders acquire the related Macquarie IMD Instalment;
- (n) no CGT event arises when the legal title to the Underlying Share is transferred by the Security Trustee to the Holder;
- (o) 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 Share is sold by Macquarie exercising its power of sale under the Security Interest. If the sale proceeds are insufficient to repay the Loan, Macquarie has no recourse against

the Holder to recover the shortfall. In this circumstance the Holder will need to reduce the cost base of the shares by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997;

- (p) any capital gain realised by a Holder on sale of an Underlying Share received pursuant to completion of a Macquarie IMD 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 Macquarie IMD Instalment for at least 12 months;
- (q) all of the income derived from the Underlying Share while the Underlying Share is the subject of the separate trust will be included in the assessable income of the Holder of Macquarie IMD Instalments (and not the Security Trustee) under section 97 of the ITAA 1936;
- (r) a CGT Event will occur under section 104-25 of the ITAA 1997 on Maturity Date if the Holder's Put Option is not exercised and lapses. The capital proceeds received on lapsing of the Holder's Put Option will be nil; and
- (s) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not be applied to deny deductibility of the Interest Amount incurred by the Holder in respect of borrowings used to fund the purchase of the Underlying Share.

## **Assumptions**

---

21. This Ruling is made on the basis of the following assumptions:
- (a) 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 Share, carrying on a business of investing in the Underlying Share, or holding the Underlying Share as trading stock or as a revenue asset;
  - (c) in respect of any interest charges to be paid in advance under the Loan Agreement, these may be prepaid, but only in relation to a loan interest payment period 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 into the arrangement is to derive assessable income from their investment in the Macquarie IMD Instalments;
- (e) at all times during the arrangement, where the Underlying Share 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 Macquarie will be at arm's length; and
- (h) the Underlying Share will not be the subject of any securities lending arrangement entered into by and on behalf of the Holder.

## **Explanation**

---

### **Section 8-1 of the ITAA 1997**

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

23. No part of the interest charged on an investment in Macquarie IMD Instalments is a capital protection fee. The capital protection is provided by the Holder's Put Option. Therefore, Holders will not be denied a deduction for any part of the interest under section 8-1, provided that the other requirements of that section are satisfied. This is the case regardless of whether the Holder acquired the Macquarie IMD Instalment by Cash Application or by purchase on the ASX.

### **Section 51AAA of the ITAA 1936**

24. By investing in Macquarie IMD Instalments, it is contemplated that a Holder will derive assessable income by the receipt of dividend income and capital gains. As the interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of net capital gains in assessable income, section 51AAA has no application to a Holder acquiring the Macquarie IMD Instalments.

**Section 82KL of the ITAA 1936**

25. 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**

26. 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***

27. 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.

28. 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***

29. 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 2 years for Macquarie IMD Instalments.

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

30. 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.

31. 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 Macquarie IMD Instalments, including the financing, share purchase, shareholding and disposal arrangements.

32. Under the arrangement, when the purchaser acquires Macquarie IMD Instalments, they acquire beneficial ownership of the Underlying Share.

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

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

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 34 to 39.

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

34. 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.

35. 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.

36. As the eligible service period in relation to the deductible interest for Macquarie IMD 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***

37. 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 carry on a business.

38. 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.

39. For these taxpayers, the deduction for the Interest Amount will be apportioned over the relevant interest payment period.

**Borrowing fee**

40. Part of the borrowing fee is for the purchase of the Holder's Put Option and the balance represents a payment for acquiring the Loan from Macquarie or for resetting the Loan Amount by Macquarie. The latter payment is deductible under section 25-25 of the ITAA 1997 over the period of the Loan.

41. The part of the borrowing fee which is applicable to the Holder's Put Option ensures that the Holder is protected from liability to repay the principal if the market value of the shares falls below their original purchase price. In effect, the Holder's Put Option ensures that Macquarie will acquire the shares in full satisfaction of the Loan Amount if the shares have fallen in value below the amount borrowed. Accordingly, the payment for the Holder's Put Option is a

capital protection fee. The payment is capital in nature, being paid to acquire an asset, namely, the Holder's Put Option.

#### **Cost Base of Holder's Put Option – Cash Applicant**

42. If the Holder's Put Option is exercised the part of the borrowing fee which is applicable to the purchase of the Holder's Put Option is included in the cost base of the Underlying Share under section 134-1 of the ITAA 1997.

43. If the Holder's Put Option is not exercised the part of the borrowing 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.

#### **Cost Base of Holder's Put Option – On-Market Purchasers**

44. If the market value of the share at the time of purchase is greater than the Completion Payment (the Loan Amount), the cost base of the Holder's Put Option is the total consideration as determined by sections 110-25 and 112-35 of the ITAA 1997 (the price of the Macquarie IMD Instalment plus the Completion Payment) less the sum of the market value of the share and the interest prepaid on the newly acquired Loan.

45. If the market value of the share at the time of the purchase is less than the Completion Payment, the cost base of the Holder's Put Option is the total consideration as determined by sections 110-25 and 112-35 (the price of the Macquarie IMD Instalment plus the Completion Payment) less the sum of the Completion Payment and the interest prepaid on the newly acquired Loan.

46. If the Holder's Put Option is exercised, the amount determined under paragraph 20(j) and the portion of the borrowing fee paid at each Annual Reset Date for acquiring the Put Option are included in the cost base of the Underlying Share under section 134-1 of the ITAA 1997.

47. If the Holder's Put Option is not exercised, the amount determined under paragraph 20(j) and the portion of the borrowing fee paid at each Annual Reset Date for acquiring the Put Option are included in the cost base of the Holder's Put Option under section 110-25 of the ITAA 1997.

#### **Section 109-5 of the ITAA 1997: time of acquisition**

48. Section 109-5 applies to a Holder to treat them as having acquired the Underlying Share at the same time from which the Holder obtains the beneficial ownership of the Underlying Share. The acquisition time for a Cash Applicant, is the time the application was accepted, and for an on-market purchaser, is the contract date for the transfer of the Macquarie IMD Instalment.

## **Subsection 104-10(7) of the ITAA 1997: time of disposal**

49. When the Completion Payment is made, no CGT event will arise in respect of the transfer of the legal title to the Underlying Share from the Security Trustee to the Holder because of subsection 104-10(7).

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

50. A CGT event will arise if the Holder does not make the Completion Payment and the Macquarie IMD Instalment or the Underlying Share is sold to Macquarie or to a third party. If the sale proceeds are insufficient to repay the Loan, Macquarie has no recourse against the Holder to recover the shortfall. In this circumstance the Holder will need to reduce the cost base of the Underlying Share by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997.

## **Section 115-5 of the ITAA 1997: CGT discount**

51. 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 Macquarie IMD Instalment or on the sale of an Underlying Share received pursuant to the completion of a Macquarie IMD 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 Macquarie IMD Instalment for at least 12 months.

52. In accordance with section 115-5, the 12 month period for the purposes of the CGT discount will run from the date of acquisition of the Macquarie IMD Instalment.

## **Section 104-25 of ITAA 1997**

53. If the Holder's Put Option lapses on the Maturity Date a CGT Event C2 will occur for the Holder. The capital proceeds received in respect of this event will be nil.

## **Section 97 of the ITAA 1936**

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

**Part IVA of the ITAA 1936**

55. 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**

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

	<b>Paragraph</b>
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	3
Class of persons	4
Qualifications	6
<b>Date of effect</b>	<b>9</b>
<b>Withdrawal</b>	<b>11</b>
<b>Arrangement</b>	<b>12</b>
<b>Participants</b>	<b>17</b>
<b>Ruling</b>	<b>20</b>
<b>Assumptions</b>	<b>21</b>
<b>Explanation</b>	<b>22</b>
Section 8-1 of the ITAA 1997	22
Section 51AAA of the ITAA 1936	24
Section 82KL of the ITAA 1936	25
Subdivision H of Division 3 of Part III of the ITAA 1936	26
<i>Subdivision 328-F and Subdivision 328-G of the ITAA 1997 – STS taxpayer</i>	27
<i>The eligible service period for the purposes of Subdivision H of Division 3 of Part III of the ITAA 1936</i>	29
<i>Sections 82KZME and 82KZMF of the ITAA 1936: prepaid expenditure and 'tax shelter' arrangements</i>	30
<i>Section 82KZM of the ITAA 1936: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure</i>	34
<i>Sections 82KZMA and 82KZMD of the ITAA 1936: prepaid non-business expenditure incurred by non-individual and non-STS taxpayers</i>	37
Borrowing Fee	40

Cost Base of the Holder's Put Option – Cash Applicant	42
Cost Base of the Holder's Put Option – On-Market Purchasers	44
Section 109-5 of the ITAA 1997: time of acquisition	48
Subsection 104-10(7) of the ITAA 1997: time of disposal	49
Section 104-10 of the ITAA 1997: CGT event A1	50
Section 115-5 of the ITAA 1997: CGT discount	51
Section 104-25 of the ITAA 1997	53
Section 97 of the ITAA 1936	54
Part IVA of the ITAA 1936	55
<b>Detailed contents list</b>	<b>56</b>

**Commissioner of Taxation**

15 September 2004

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

## ATO references

NO: 2004/8860

ISSN: 1441-1172