



PR 2005/104 - Income tax: tax consequences of investing in Greenway Notes

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 This document has changed over time. This is a consolidated version of the ruling which was published on *10 August 2005*



Product Ruling

Income tax: tax consequences of investing in Greenway Notes

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

Preamble

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

No guarantee of commercial success

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

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

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

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

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

Terms of use of this Product Ruling

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 referred to is the acquisition of Notes to be issued by Greenway Capital Nominees Limited.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 26BB of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 70B of the ITAA 1936;
- section 97 of the ITAA 1936; and
- section 159GP of the ITAA 1936.

Changes in the Law

3. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

4. Taxpayers who are considering participating in the arrangement that is the subject of this Ruling are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Class of persons

5. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date of this Ruling. They will have, at the time of entering into the arrangement, the purpose of staying in the arrangement until it is completed and of deriving assessable income from their involvement as set out in the description of the arrangement. In this Ruling those persons are referred to as either 'Investors' or 'Note Holders'.

Qualifications

6. The Commissioner rules on the precise arrangement identified in the Ruling. 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. The Ruling will be withdrawn or modified.

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Date of effect

8. This Ruling applies prospectively from 10 August 2005, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

9. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

10. This Product Ruling is withdrawn and ceases to have effect after 30 June 2008. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. 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 change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

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

- Application for a Product Ruling dated 26 April 2005 as constituted by documents received on 15 March 2005, made on behalf of Greenway Capital Nominees Limited (GCNL);
- Additional correspondence dated 14 June 2005 and 20 July 2005;
- Draft Greenway Master Trust Deed to be executed by GCNL dated 11 March 2005;
- Draft Subscription Agreement - Greenway Origination Trust No. 1 between GCNL and the Subscriber, dated 13 April 2005;
- Draft Deed Poll for Greenway Notes in respect of the Greenway Origination Trust No. 1 to be executed by GCNL, dated 11 March 2005;
- Draft Creation Notice for Greenway Origination Trust No. 1, dated 13 April 2005;
- Draft Series Notice for Greenway Origination Trust No. 1, dated 11 March 2005;
- Draft Security Trust Deed – Greenway Origination Trust No. 1 between the Security Trustee and GCNL and Greenway Capital Services Pty Ltd, dated 11 March 2005;
- Draft Deed of Charge – Greenway Origination Fund No. 1 between GCNL and the Security Trustee, dated 11 March 2005;
- Draft Memorandum of Mortgage Common Provisions, dated 11 March 2005; and
- Draft GEM Facility Agreement, dated 11 March 2005.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

12. Based on the information provided on behalf of GCNL, the agreements highlighted above will govern the Notes covered by this Ruling. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor, or any associate of an Investor, will be a party to, which are a part of the arrangement. In this Ruling the term 'associate' has the meaning given by section 318 of the ITAA 1936. A summary of the terms of each of these agreements are provided below.

13. In this Ruling, unless otherwise defined, capitalised terms take their meaning as per the agreements highlighted in paragraph 11.

14. All Australian Securities and Investment Commission requirements are, or will be, complied with for the term of the agreements.

The Trusts established under the Greenway Master Trust Deed

15. Under this arrangement GCNL will establish one or more Trusts, to fund or hold Greenway Equity Mortgages (GEMs).

16. In its application for this Product Ruling GCNL has provided a description of the activity of each of the Trusts that will be established under the Greenway Master Trust Deed. This activity will be implemented in accordance with the agreements described below.

17. According to the arrangement:

- GCNL will establish the Greenway Origination Trust No. 1 (the Origination Trust) to provide loans to be known as GEMs. A GEM is secured by a mortgage issued over residential property;
- a securitisation event will take place periodically. This will involve the transfer of a portfolio of GEMs from the Origination Trust to a Greenway Term Trust (Term Trust);
- the Origination Trust and Term Trust will fund the GEMs and acquisition of GEMs, respectively, by issuing Notes to Investors;
- under the provisions of the GEM Facility Agreement, a mortgagor is not required to pay principal and interest during the life of the loan and on termination of the GEM, the mortgagee is entitled to repayment of the loan and a share of the incremental gain in value of the mortgaged property between the time the loan is made and its termination;
- the income of the Origination Trust for a year of income includes, among other things, the gains on GEMs realised during the year and the gains realised on a transfer of a portfolio of GEMs to a Term Trust; and
- the income of the Term Trust for a year of income includes, among other things, the gains on GEMs repaid during the year.

Greenway Master Trust Deed

18. The Greenway Master Trust Deed (the Trust Deed) sets out the procedures involved in the creation of separate and distinct Trusts. These include the completion of a Creation Notice each time a Trust is established. Each Trust will own its pool of assets and the funding for each Trust is independent of the other Trusts and the assets of a Trust cannot be used to meet the liability of another Trust (clause 2.2).

19. The Trust Deed also sets out the terms and conditions under which GCNL accepts the appointment as Trustee of each Trust. As Trustee, GCNL has the power to borrow or raise money by way of issue or creation of Notes (clause 10). A Note may be issued anytime in accordance with a Series Notice and the Trustee can also issue Notes through an Asset Notice to acquire a Portfolio of Assets owned by another Trust established under the Trust Deed.

20. Under the arrangement, Investors who subscribe to the Notes are referred to as Note Holders and are bound by the provisions of the Trust Deed. The Trustee must prefer the interest of Note Holders over Unit Holders (clause 10.1). Note Holders are as Income Beneficiaries presently entitled to the Distributable Amount in proportion to their respective entitlements at the end of each Distribution Period (clause 11).

21. In summary, the Trust Deed also sets out provisions relating to:

- the appointment and removal of the Trustee (clause 3);
- the term of a Trust (clause 4);
- the issue of Units in a Trust (clause 5);
- the transfer, disposition, register and redemption of Units (clauses 6 and 7);
- the Trustee's general and specific powers and duties (clauses 8, 9 and 10);
- the Trustee's fees and order of payments (clause 16); and
- valuation of Assets (clause 17.5).

Subscription Agreement

22. The Subscription Agreement between GCNL and the Investor sets out the terms and conditions in subscribing for Notes which will be known as Greenway Notes. Schedule 1 of the Agreement will specify the total Application Price or the Commitment amount which is the total amount to be paid for the Notes.

23. Under the terms of this agreement, the Commitment amount will be payable in Instalments by the due date specified in the Instalment Notice (clause 3.2). An Investor will be liable to pay interest for failure to pay an Instalment by the due date (clause 3.3).

24. The Subscription Agreement provides that the Trustee may choose to pay an Investor an amount calculated as a portion of the performance fee received by the Trustee. According to the Creation Notice provided with the application for this Product Ruling, the performance fee will be calculated as a percentage per annum of so much of the operating income of the year which exceeds an amount equal to the performance hurdle applicable to the Notes.

Deed Poll for Greenway Notes

25. The Deed Poll for Greenway Notes (the Deed Poll) which will be executed by GCNL in favour of each Note Holder sets out some of the terms and conditions attached to each Greenway Note.

26. A Note will have a Face Amount of \$10,000 and Notes will be issued in minimum parcels of \$500,000 and in integral multiples of \$50,000 thereafter. Each Note is a separate debt of GCNL. GCNL must pay this amount on the Maturity Date specified in the Register. However, partial or full repayment of the amount can be made anytime at the discretion of GCNL. Any earlier repayment must be made on a Distribution Date. This date, which is determined in accordance with the Trust Deed, is the latest date that the Trustee must pay Income Entitlements to the Income Beneficiaries. A Note Holder does not have the right to demand or request early repayment of the amount and interest is not payable on each Note.

27. An Outstanding Principal Balance in respect of a Note is reduced by a payment by GCNL and as provided in clause 6.5 of the Deed Poll, by the amount of the Realised Losses in respect of all Receivables during the Distribution Period. The Note is cancelled if the Outstanding Principal Balance is reduced to zero before the Maturity Date specified in the Register.

28. The Deed Poll also sets out the mechanism and limitations of transferring a Note to another person. Clause 5.4 provides that no transfer of a Note will be registered and the Register will be closed during a specified period before and after a Distribution Date for the purpose of determining entitlements to payments with respect to a Note.

Transaction Documents

29. The Trust Deed and the Subscription Agreement define documents that are Transaction Documents and these include a Creation Notice and a Series Notice. Both of these notices can be used as instruments to amend the Trust Deed and any amendments will prevail over the Trust Deed.

30. Transaction Documents also include any documents acknowledged to be Transaction Documents. **This Product Ruling does not apply if any Transaction Document is inconsistent with the arrangement as described in this Ruling.**

Ruling

31. Subject to the assumptions listed in paragraph 32 of this Ruling:
- (a) a Note issued to an Investor by a Trust established under the Greenway Master Trust Deed is not a 'qualifying security' as defined in subsection 159GP(1) of the ITAA 1936;
 - (b) any gain on disposal or redemption of Notes is to be included in assessable income of the Investor under section 26BB of the ITAA 1936;
 - (c) subject to the qualifications in that section, any loss made on disposal or redemption of Notes will be an allowable deduction to the Investor under section 70B of the ITAA 1936;
 - (d) section 97 of the ITAA 1936 will apply to assess an Investor on their share of the net income of the Trust; and
 - (e) an Investor's share of the performance fee (see paragraph 24) is to be included in assessable income of the Investor under section 6-5 of the ITAA 1997.

Assumptions

32. This Ruling is made on the basis of the following assumptions:
- (a) all of the Investors are Australian residents for taxation purposes;
 - (b) the Notes are not trading stock of the Investor;
 - (c) the purpose of an Investor in entering into the arrangement is to derive assessable income from their investment in Notes;
 - (d) the arrangement will be executed in the manner described in the Arrangement section of this Ruling; and
 - (e) all dealings by the Investor, GCNL and Trusts established under the Greenway Master Trust Deed will be at arm's length.

Explanation

Division 16E of Part III of the ITAA 1936

33. Division 16E, more specifically section 159GQ, imposes a statutory accruals regime on certain payments in relation to a 'security' that is a 'qualifying security'.

34. A Note is a 'security' for the purposes of Division 16E. The term 'security' is defined widely in subsection 159GP(1) to include, amongst other things, a 'debenture' (paragraph (a)). A debenture is defined in section 995-1 of the ITAA 1997 to include a 'note'.

35. The term 'qualifying security' is also defined in subsection 159GP(1). One of the elements of that definition is that the security under consideration must have an 'eligible return'.

36. A security will have an 'eligible return' for the purposes of Division 16E if, at the time the security is issued it is reasonably likely, by reason that the security was issued at a discount, bears deferred interest or is capital indexed or for any other reason, having regard to the terms of the security, that the sum of all payments, other than periodic interest payments, under the security will exceed the issue price of the security (subsection 159GP(3)). The 'issue price' in relation to a security means the consideration (if any) for the issue of the security (subsection 159GP(1)).

37. Under the arrangement, the issue price in relation to a Note represents the principal amount to which Note Holders are entitled to be paid. However any principal amount outstanding is also reduced by the amount of the Realised Losses in respect of all Receivables during the Distribution Period.

38. Note Holders are entitled to the income of the Trust. It is contemplated that this income will be generated through net gains on GEMs realised during the year through transfer of a portfolio or GEMs repaid during the year. According to GCNL, the transfer price that will be realised by the Originating Trust is unpredictable at the outset of making a GEM loan, as it will depend on variables such as changes in residential property values between the time the GEMs are made and the securitisation event takes place. Likewise, potential gains on GEMs held by any Term Trust will be dependent on property values when a GEM contract is terminated.

39. Having considered these features of the Note, it cannot be determined at the time the Note is issued that it is reasonably likely that the sum of all payments (other than periodic interest payments) under the security will exceed the issue price of the security. Accordingly, a Note that will be issued in accordance with the arrangement described in this Ruling will not have an eligible return and is not a 'qualifying security' for the purposes of Division 16E.

Sections 26BB and 70B of the ITAA 1936 – gains or losses on traditional securities

40. Sections 26BB and 70B deal with the assessability and deductibility of gains or losses made on the disposal or redemption of traditional securities. Those provisions set out the circumstances when that gain or loss is assessable or deductible. The Commissioner's views on some interpretative matters in relation to these provisions are set out in Taxation Ruling TR 96/14.

41. A Note that will be issued by GCNL comes within the definition of a 'traditional security' in subsection 26BB(1) because it is a 'security' that will be held by an Investor on full payment of the Face Amount, its acquisition date will be after May 1989, it will not have an 'eligible return' and it will not be a prescribed security within the meaning of section 26C. It is assumed that the Note is not a trading stock of the Investor. The term 'security' takes its meaning from subsection 159GP(1) (see paragraph 34).

Section 97 of the ITAA 1936 – assessability of income from a Trust

42. In accordance with the Trust Deed, Investors who become Note Holders will be presently entitled to the Distributable Amount in proportion to their respective entitlements at the end of each Distribution Period. Accordingly, section 97 will apply to assess Note Holders on the income derived from the Trust.

Section 6-5 of the ITAA 1997 – assessability of rebate of performance fees

43. Subsection 6-5(1) provides that the assessable income of an Australian resident includes income according to ordinary concepts. Whether or not a particular amount is income according to ordinary concepts depends on the nature and character of the receipt in the hands of the taxpayer.

44. The Subscription Agreement provides that an Investor is entitled to a portion of the performance fee. In its application for this Product Ruling, GCNL has stated that the relevant conditions for this entitlement, which is described as a rebate of performance fee, will only apply to:

- performance fees generated from funds invested in the first and second closings of the Origination Trust; and
- performance fees generated from investments in the first five fund raisings in the Term Trust.

45. Satisfaction of these conditions will result in affected Investors having derived a portion of the performance fee received by the Trustee as income according to ordinary concepts.

Detailed contents list

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

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
TR 96/14; TR 97/16; TD 93/34

Subject references:

- deferred interest securities
- eligible return
- issue price
- product rulings
- public rulings
- qualifying security
- securities
- traditional securities

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 26BB
- ITAA 1936 26BB(1)
- ITAA 1936 70B
- ITAA 1936 97
- ITAA 1936 Pt III Div 16E
- ITAA 1936 159GP
- ITAA 1936 159GP(1)
- ITAA 1936 159GP(3)
- ITAA 1936 159GQ
- ITAA 1936 318
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 995-1
- Copyright Act 1968

ATO references

NO: 2005/4059

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ finance