



PR 2006/104 - Income tax: tax consequences of investing in Westpac 'IWP' Series Instalments - 2003 Product Disclosure Statement and 2005 Supplementary Product Disclosure Statements - 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 7 June 2006



Product Ruling

Income tax: tax consequences of investing in Westpac 'IWP' Series Instalments – 2003 Product Disclosure Statement and 2005 Supplementary Product Disclosure Statements – cash applicants and on-market purchasers

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	10
Withdrawal	14
Scheme	15
Ruling	21
Assumptions	22
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	23
Appendix 2:	
Detailed contents list	55

❶ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document.

If the scheme 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 scheme 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 scheme has been implemented as described below and to ensure that the participants in the scheme 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 entity(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 Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.
2. This Ruling does not address:
 - a Holder's entitlement to franking credits; and
 - the tax consequences of the Reset Cash Back that is provided as a cash payment on a Reset Date.

Relevant provision(s)

3. The relevant provisions 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 116-20 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 entities

4. The class of entities to which this Ruling applies is those who enter into the scheme 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 scheme, a purpose of staying in the scheme until it is completed and of deriving assessable income from their involvement as set out in the description of the scheme. In this Ruling these entities are referred to as 'Holders'.

5. This Ruling does not address the tax consequences for entities 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 scheme identified in the Ruling.

7. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 15 to 20.

8. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

10. This Ruling applies prospectively from 7 June 2006, 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

14. This Product Ruling is withdrawn and ceases to have effect after 30 June 2009. The Ruling continues to apply, in respect of the relevant provisions ruled upon, to all entities within the specified class who enter into the specified scheme during the term of the Ruling. Thus, the Ruling continues to apply to those entities, even following its withdrawal, who entered into the specified scheme prior to withdrawal of the Ruling. This is subject to there being no material difference in the scheme or in the entities' involvement in the scheme.

Scheme

15. The scheme that is the subject of this Ruling is described below. This description incorporates the following documents:

- application for a Product Ruling dated 3 May 2006 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;
- Deed Poll – Warrant Terms dated 18 December 2003 executed by Westpac;
- Deed of Retirement and Appointment dated 1 April 2005 executed by Westpac;
- Product Disclosure Statement for Westpac Instalments dated 19 December 2003 (which includes the terms of the Loan Agreement); and
- Supplementary Product Disclosure Statements for Westpac Instalments dated 11 January 2005 and 17 June 2005 (Supplementary Product Disclosure Statements).

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

17. The details of the scheme the subject of this Ruling are summarised as follows:

- (a) Westpac IWP Instalments are a leveraged investment under which a Holder acquires a beneficial interest in shares listed on the ASX (Security) using a limited recourse Loan made by Westpac. The Security, together with any attached Accretions, is referred to as the 'Underlying Parcel';
- (b) the Loan Amount is determined by Westpac having regard to the value of the Underlying Parcel. For Westpac IWP Instalments, the Loan Amount is set at approximately 70-95% of the value of the Underlying Parcel. The Supplementary Product Disclosure Statements specify the Loan Amount for Westpac IWP Instalments over each Security. The Loan Amount is fixed until the first Reset Date at which time Westpac may reset the Loan Amount having regard to movements in the value of the Underlying Parcel;
- (c) interest on the Loan is payable annually in advance for the period to the next Reset Date (the Interest Amount);

- (d) 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;
- (e) Holders may repay the Loan on any Reset 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;
- (f) 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;
- (g) Westpac grants the Holder a Put Option on Cash Application and on each Reset Date. The Put Option is exercisable on the next Reset Date or, in respect of the Put Option granted on the final Reset Date, the Completion Date. As consideration for each Put Option, the Holder is charged a Put Option Fee on Cash Application and each Reset Date;
- (h) Westpac IWP 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 IWP 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 partly fund the acquisition of the Underlying Parcel by the Security Trustee;
 - the Interest Amount;
 - the non-refundable Put Option Fee which is the cost of Westpac providing the Holder with the Put Option to the next Reset Date; 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;

- (i) Westpac IWP Instalments are also listed on the ASX so that investors may participate by purchasing Westpac IWP Instalments on-market;
- (j) where a Westpac IWP Instalment is purchased on the ASX, the purchaser acquires the Westpac IWP 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 Reset Date (which is used to refund part of the interest prepaid by the seller), and discharge the seller's Loan;
- (k) during the life of the Westpac IWP Instalment, Holders will be entitled to all dividends and distributions paid on a Security in the Underlying Parcel (Special Dividends, however, may be applied by the Security Trustee in reduction of the Completion Payment). A Holder is not entitled to direct the Security Trustee to exercise any voting rights in relation to a Security;
- (l) there are six annual Reset Dates specified in the Supplementary Product Disclosure Statements. On each Reset Date, Westpac may reset the Loan Amount having regard to the value of the Underlying Parcel. The Interest Amount, the Put Option Fee and Borrowing Fees (if any) are payable on each Reset Date. Holders have a number of options on a Reset Date:
 - 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 the reset Loan Amount is greater than the Current Loan Amount by an amount more than the Interest Amount, Put Option Fee and Borrowing Fees (if any), the Holder may receive additional Westpac IWP Instalments;
 - if the reset Loan Amount is equal to or less than the Current Loan Amount, or is greater than the Current Loan Amount by an amount less than the sum of the Interest Amount, the Put Option Fee and the Borrowing Fees (if any), the Holder may make a Reset Payment to Westpac in order to continue to hold the same number of Westpac IWP Instalments. If the Holder fails to make the Reset Payment in these circumstances, Westpac is entitled to 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, Westpac may apply the proceeds to make the Reset Payment in respect of other Westpac Instalments of the Holder for which no Reset Payment was received, or provide the Holder the excess. Due to the limited recourse nature of the Loan, if the sale proceeds obtained by Westpac are less than the outstanding Loan, Westpac is not entitled to recover the balance from the Holder; or
 - if offered, apply to rollover the Westpac IWP Instalments to a future series of Westpac Instalments; and
- (m) at the Completion Payment Date the following options are available to Holders of Westpac IWP 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;
 - do nothing, in which case 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; or

- if offered, apply to rollover the Westpac IWP Instalments to a future series of Westpac Instalments.

Participants

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

19. Westpac Custodian Nominees Limited, as Security Trustee, holds the legal title to each Underlying Parcel for each Holder.

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

Ruling

21. Subject to the Assumptions in paragraph 22 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 IWP 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 IWP 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) section 82KZMD of the ITAA 1936 will apply to determine the amount and timing of deductions for the Interest Amount incurred under a Westpac IWP 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) any Borrowing Fee charged on application and on each Reset Date is deductible under section 25-25 of the ITAA 1997 over the shorter of 5 years and the remaining period of the Loan;
- (h) for Cash Applicants, 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) for Cash Applicants, 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:
 - 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 IWP Instalments plus the purchaser's Loan Amount less the sum of the market value of the Security and the Interest Amount prepaid by the purchaser on the Loan Amount; and
 - 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 IWP 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 21(j) will be included in the cost base of the Underlying Parcel under section 134-1 of the ITAA 1997;
- (l) for on-market purchasers, if the Put Option is not exercised, the amount determined under paragraph 21(j) will be included in the cost base of the Put Option under section 110-25 of the ITAA 1997;

- (m) CGT event C2 will occur under section 104-25 of the ITAA 1997 on the Completion Payment Date or a Reset Date if the Put Option is not exercised and expires. The capital proceeds received on expiration of the Put Option will be nil under section 116-20 of the ITAA 1997;
- (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 IWP Instalments, the contract date for transfer of the Westpac IWP 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 IWP Instalment pursuant to subsection 104-10(7) of the ITAA 1997;
- (p) CGT event A1 will arise under section 104-10 of the ITAA 1997 to the Holder where the Completion Payment is not made or a Reset Payment is not made 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 in accordance with section 116-20 of the ITAA 1997;
- (q) any capital gain realised by a Holder on sale of the Westpac IWP Instalment or on sale of an Underlying Parcel received pursuant to completion of a Westpac IWP 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 Westpac IWP 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; 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 IWP Instalment.

Assumptions

22. 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 scheme is to derive assessable income from their investment in the Westpac IWP Instalments;
- (e) the scheme will be executed in the manner described in the 'Scheme' section of this Ruling;
- (f) all dealings by the Holders and Westpac will be at arm's length; and
- (g) the Underlying Parcel will not be the subject of any securities lending arrangement entered into by or on behalf of the Holder.

Commissioner of Taxation

7 June 2006

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Section 8-1 of the ITAA 1997

23. The cost (or interest paid) of a borrowing used to acquire income producing assets such as shares 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).

24. 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 IWP Instalment by Cash 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 scheme is provided by the Put Option.

Section 51AAA of the ITAA 1936

25. By acquiring the Westpac IWP Instalment it is contemplated that a Holder will derive assessable income by the receipt of dividends 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 IWP Instalment.

Section 82KL of the ITAA 1936

26. 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

27. 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

28. 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.

29. 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

30. 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 6 years and 5 months for Westpac IWP Instalments.

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

31. 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.

32. 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 IWP Instalment, including the financing, the purchase of a Security, the holding of a Security and the disposal arrangements.

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

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

- (a) the Interest Amount is incurred in respect of money borrowed to acquire shares that are listed for quotation on the ASX;
- (b) the Holder can reasonably be expected to obtain dividends 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 IWP Instalments are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 35 to 40 of this Ruling.

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

35. 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.

36. 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.

37. As the eligible service period in relation to the deductible interest for Westpac IWP 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

38. Section 82KZMD sets 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.

39. Section 82KZMA requires that 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.

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

Borrowing Fee

41. Borrowing Fees, if any, relate to the cost of Westpac making the Loan available to the Holder. As the funds are used for income producing purposes, any Borrowing Fees charged on application or on a Reset Date will be deductible to the Holder 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

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

43. 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

44. 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 IWP Instalment plus the purchaser's Loan Amount less the sum of the market value of the Security and the interest prepaid by the purchaser on the Loan Amount.

45. 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 IWP 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.

46. If the Put Option is not exercised, the amount determined under paragraph 21(j) is included in the cost base of the Put Option under section 110-25 of the ITAA 1997.

47. If the Put Option is exercised, the amount determined under paragraph 21(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

48. On the Completion Payment Date or a Reset Date, if the Put Option is not exercised, it 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 expiration of the Put Option will be nil under section 116-20 of the ITAA 1997.

Section 109-5 of the ITAA 1997 – acquisition of a CGT asset

49. 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 IWP Instalment.

Subsection 104-10(7) of the ITAA 1997 – no CGT event when Completion Payment made

50. 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

51. CGT event A1 will arise to the Holder if the Holder does not pay the Completion Payment or the Reset Payment 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 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

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

Section 97 of the ITAA 1936

53. The Holders are presently entitled to all of the income derived from the Underlying Parcel. 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

54. Provided that the scheme ruled on is entered into and carried out as disclosed (see the Scheme part of this Ruling), it is accepted that the scheme is an ordinary commercial transaction and Part IVA will not apply.

Appendix 2 – Detailed contents list

55. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Relevant provision(s)	3
Class of entities	4
Qualifications	6
Date of effect	10
Withdrawal	14
Scheme	15
Participants	18
Ruling	21
Assumptions	22
Appendix 1 – Explanation	23
Section 8-1 of the ITAA 1997	23
Section 51AAA of the ITAA 1936	25
Section 82KL of the ITAA 1936	26
Subdivision H of Division 3 of Part III of the ITAA 1936	27
Subdivision 328-F and Subdivision 328-G of the ITAA 1997 – STS taxpayer	28
The eligible service period for the purposes of Subdivision H of Division 3 of Part III of the ITAA 1936	30
Sections 82KZME and 82KZMF of the ITAA 1936: prepaid expenditure and 'tax shelter' arrangements	31
Section 82KZM of the ITAA 1936: prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure	35
Sections 82KZMA and 82KZMD of the ITAA 1936: prepaid non-business expenditure incurred by non-individual and non-STs taxpayers	38
Borrowing Fee	41
Cost base of the Put Option – Cash Applicant	42
Cost base of the Put Option – on-market purchasers	44
Section 104-25 of the ITAA 1997	48
Section 109-5 of the ITAA 1997 – acquisition of a CGT asset	49
Subsection 104-10(7) of the ITAA 1997 – no CGT event when Completion Payment made	50

PR 2006/104

Section 104-10 of the ITAA 1997 – CGT event A1	51
Section 115-5 of the ITAA 1997 – discount capital gains	52
Section 97 of the ITAA 1936	53
Part IVA of the ITAA 1936	54
Appendix 2 – Detailed contents list	55

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Not previously issued as a draft

Related Rulings/Determinations:

TR 95/33

Subject references:

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- interest expenses
- prepaid expenses
- product rulings
- public rulings
- small business taxpayer
- tax avoidance
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