



PR 2006/126 - Income tax: deductibility of interest incurred on borrowings under the Suncorp Protected Loan

 This cover sheet is provided for information only. It does not form part of *PR 2006/126 - Income tax: deductibility of interest incurred on borrowings under the Suncorp Protected Loan*

 This document has changed over time. This is a consolidated version of the ruling which was published on *6 September 2006*



Product Ruling

Income tax: deductibility of interest incurred on borrowings under the Suncorp Protected Loan

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① 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. In this Ruling the scheme involves the grant of a put option and the borrowing of money from Suncorp-Metway Limited (Suncorp) under the terms of the Suncorp Protected Loan (PL) which are supplementary to the Suncorp Margin Lending Terms and Conditions. The borrowings are used to fund the acquisition of shares listed on the Australian Stock Exchange (ASX) and/or units in widely held unit trusts.

2. This Ruling does not address the tax consequences of:
- terms that are not for fixed periods of one, two, three, four or five years;
 - the security deposit feature;
 - the Savings Gearing Loan Facility;
 - investing in stapled securities under the terms of the PL;
 - trading in specified securities during the course of the PL;
 - drawing down excess funds from the PL;
 - writing call options over specified securities using the Share Option Plan;
 - early repayment or termination of the PL;
 - repaying the loan using the limited recourse provisions;
 - converting the PL to a standard margin loan; and
 - extending the term of the PL at expiry time;

which are available and described in the draft Suncorp Margin Lending Terms & Conditions and the draft Protected Loan Supplementary Terms & Conditions.

3. This Ruling does not address an investor's entitlement to franking credits.

Relevant provision(s)

4. The relevant provisions dealt with in this Ruling are:
- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-25 of the ITAA 1997;
 - section 110-25 of the ITAA 1997;
 - section 110-55 of the ITAA 1997;

- Division 134 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; and
- Part IVA of the ITAA 1936.

Class of entities

5. The class of entities to which this Ruling applies is those who enter into the scheme described below on or after the date this Ruling is made. They will have 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 persons are referred to as 'Investors'.

Qualifications

6. 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 13 to 16 of this Ruling.

7. 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

9. This Ruling applies prospectively from 6 September 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 a 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.

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)).

10. 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.

11. 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

12. This Product Ruling is withdrawn and ceases to have effect after 30 June 2010. 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

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

- application for a Product Ruling dated 30 June 2006 received from Suncorp-Metway Limited on 13 July 2006;

- draft Suncorp Protected Loan Supplementary Terms & Conditions;
- draft Suncorp Margin Lending Terms & Conditions and Application Forms;
- Margin Lending Protected Loans Application form;
- Margin Lending Protected Loan Identification Notice; and
- additional information provided on 24 and 28 July 2006.

14. The details and aspects of the scheme subject to this Ruling are summarised as follows:

- (a) the PL involves the granting of a put option (Put Option) and the making of a limited recourse loan to an Investor. The Investor may choose a fixed loan term of one, two, three, four or five years;
- (b) the minimum loan amount is \$40,000, and thereafter in additional increments of \$10,000 (or amounts that correspond to 1000 shares/units of specified securities the Investor will acquire with the loan proceeds);
- (c) the loan is used by the Investor to finance 100% of the purchase price of a portfolio of specified securities (Protected Securities) in the Investor's name;
- (d) the Protected Securities are selected by an Investor from a list of shares listed on the ASX and/or units in a unit trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936, which are approved by Suncorp;
- (e) the Investor grants a mortgage to Suncorp over the Protected Securities as security for the PL;
- (f) the rate of interest charged by Suncorp under the PL varies according to the term of the PL, with the shorter the period of the PL and the more volatile the prices of the Protected Securities, the higher the rate of interest charged;
- (g) the rate of interest charged is fixed for the term of the PL, and is payable either monthly or annually in advance;
- (h) under the PL, the Investor is granted a Put Option to sell the Protected Securities to Suncorp for the amount of principal outstanding under the PL which relates to those Protected Securities;
- (i) a portion of the interest payable under the PL is referable to a premium for the Put Option. This is the amount as calculated in paragraph 17(b) of this Ruling;

- (j) provided the Put Option is not exercised, the PL is made on a limited recourse basis. As such, Suncorp's right to repayment of the PL is limited to the amount it can obtain by enforcing its right as mortgagee in respect of the Protected Securities;
- (k) if the Put Option is exercised by the Investor, the Protected Securities will be transferred to Suncorp for the principal amount outstanding under the PL, and this will result in the discharge of the PL;
- (l) the Put Option may only be exercised by the Investor (or in limited circumstances by Suncorp or a nominee, on the Investor's behalf) not less than seven Business Days before the Expiry Time of the PL; and
- (m) no later than seven Business Days before the Expiry Time of the PL, an Investor must elect to:
 - (i) repay the total amount owing on the PL;
 - (ii) instruct Suncorp or a nominee to sell the Protected Securities and discharge the PL on their behalf;
 - (iii) exercise their right under the Put Option to require Suncorp to purchase the Protected Securities;
 - (iv) extend the term of the PL (subject to Suncorp's consent);
 - (v) convert the PL to a standard margin loan; or
 - (vi) if neither (i), (ii), (iii), (iv) or (v) applies, the Investor will be deemed to have nominated Suncorp or a nominee either:
 - (a) to exercise the Put Option on the Investor's behalf, requiring Suncorp to purchase the Protected Securities; or
 - (b) to sell the Protected Securities on their behalf and discharge the PL.

The Participants

15. Suncorp provides the PL to Investors to fund the acquisition of the Protected Securities and grants the Put Options to Investors.

16. The Investors may be individuals, companies or trusts.

Ruling

17. Subject to paragraphs 2, 3 and 18 of this Ruling:

(a) the PL interest charge allowable under section 8-1 of ITAA 1997 is the amount that does not exceed the lower of the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans or the relevant percentage of the total interest charged by Suncorp under the PL as follows:

- (i) 60% for PL with a term of 1 year;
- (ii) 72.5% for PL with term of 2 years;
- (iii) 80% for PL with a term of 3 years;
- (iv) 82.5% for PL with a term of 4 years;
- (v) 85% for PL with a term of 5 years.

As the interest charged on the PL is a fixed rate, the Reserve Bank Bulletin Indicator Lending Rate for Personal Unsecured Loans Fixed is to be used;

(b) the difference between the total interest charged on the PL and the amount allowable as a deduction under paragraph 17(a) of this Ruling is not allowable as a deduction under section 8-1 of the ITAA 1997. This non deductible amount represents the payment of the premium for the Put Option by instalments (Put Premium);

(c) section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction for the interest charge allowable under section 8-1 of the ITAA 1997;

(d) section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest charge allowable under section 8-1 of the ITAA 1997;

(e) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the interest charge allowable under section 8-1 of the ITAA 1997;

(f) section 82KZM of the ITAA 1936 will not apply to deny an Investor immediate deductibility of any part of the interest charge allowable under section 8-1 of the ITAA 1997 where at least one of the following applies for the year of income:

- (i) the Investor is an STS taxpayer; or
- (ii) the Investor is an individual who does not incur the interest charge in carrying on a business;

- (g) section 82KZMD of the ITAA 1936 will apply to set the amount and timing of the deductions for the interest charge that is deductible under section 8-1 of the ITAA 1997 to an Investor (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;
- (h) the Put Premium will be included in the first element of the cost base and the reduced cost base of the Put Option under subsections 110-25(2) and 110-55(2) of the ITAA 1997;
- (i) if the Put Option is exercised, the Put Premium will be included in the second element of the cost base and reduced cost base of the Protected Securities under subsection 134-1(1) of the ITAA 1997. Any gain or loss on exercise of the Put Option will be disregarded by virtue of subsection 134-1(4) of the ITAA 1997;
- (j) if the Put Option is not exercised and it expires, a CGT event C2 will happen under paragraph 104-25(1)(c) of the ITAA 1997. The Investor will make a capital loss equal to the reduced cost base of the Put Option under subsection 104-25(3); and
- (k) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not be applied to deny deductibility of the interest charge allowable under section 8-1 of the ITAA 1997 in respect of the borrowing by the Investor under the PL.

Assumptions

18. This Ruling is made on the basis of the following necessary assumptions:

- (a) the Investors are Australian residents for taxation purposes;
- (b) the Investors are not traders in investments and are not treated for taxation purposes as trading in the Protected Securities, carrying on a business of investing in the Protected Securities, or holding the Protected Securities as trading stock or as revenue assets;
- (c) interest charges paid in advance under the PL may be prepaid only in relation to a loan interest payment period of 12 months or less, and which ends on or before the last day of the income year following the expenditure year;

- (d) the dominant purpose of an Investor entering into the scheme is to derive assessable income comprising dividends or trust distributions and capital gains;
- (e) the scheme will be executed in the manner described in the 'Scheme' section of this Ruling; and
- (f) all dealings by Investors and Suncorp will be at arm's length.

Commissioner of Taxation
6 September 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

19. 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 assessable income will be derived from the investment (see Taxation Ruling TR 95/33).

20. Investors should only claim interest deductions on the PL equal to the amount determined under paragraph 17(a) of this Ruling.

21. The difference between the total interest charged on the PL and the amount deductible under section 8-1 is the amount of interest allocated to the Put Premium. The payment of the Put Premium ensures that the Investor is protected from liability to repay the principal if the market value of the Protected Securities acquired under the PL falls below their original purchase price. The Put Premium is not deductible under section 8-1.

Section 51AAA of the ITAA 1936

22. Under the PL it is contemplated that an Investor will derive assessable income by way of dividends and or trust income and capital gains. As the interest allowable under section 8-1 of the ITAA 1997 would have been deductible notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA has no application to an Investor in the PL.

Section 82KL of the ITAA 1936

23. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient additional benefits will be provided to trigger the application of section 82KL. It will not apply to deny a deduction otherwise allowable under section 8-1 of the ITAA 1997.

Subdivision H of Division 3 of Part III of the ITAA 1936

24. This Subdivision deals with the timing of deductions for certain advance expenditure incurred under an agreement in return for the doing of a thing under that agreement that will not be wholly done within the same year of income. Separate rules apply depending on whether the expenditure is incurred in carrying on a business, whether the Investor is an 'STS taxpayer', whether the Investor is an individual and whether the taxpayer 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) of the ITAA 1936 to include amounts of less than \$1,000 or amounts of expenditure that are of a capital nature.

Subdivisions 328-F and 328-G of the ITAA 1997 – STS taxpayer

25. An Investor will be an STS taxpayer for an income year if the Investor is eligible to be an STS taxpayer for that year and the Investor notifies the Commissioner of the choice to become such a taxpayer for that year.

26. An Investor will be eligible to be an STS taxpayer for an income year if the Investor carries on a business and the STS average turnover of the business and related business for that year is less than \$1 million and the business and related businesses have depreciating assets with a total adjustable value below \$3 million at the end of that year.

The eligible service period for the purposes of Subdivision H of Division 3 of Part III of the ITAA 1936

27. The interest charge on the PL allowable under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is 12 months or less. 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, and not to the period of the loan.

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

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

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

30. Exception 1, as contained in subsection 82KZME(5), applies to exclude the interest charge allowable under section 8-1 of the ITAA 1936 incurred on borrowings under the PL from the operation of section 82KZMF, as:

- the prepaid interest expenditure allowable under section 8-1 of the ITAA 1997 for the PL is incurred in respect of money borrowed to acquire shares that are listed for quotation on the Australian Stock Exchange and/or units in a unit trust as described in subparagraph 82KZME(5)(b)(iii);
- the Investor can reasonably be expected to obtain dividend or trust income from the investment;
- the Investor will not obtain any other kind of assessable income from the investment, except for capital gains; and
- all aspects of the PL are at arm's length.

Deductibility of the expenditure must therefore be considered under the prepayment rules outlined in paragraphs 31 to 37 of this Ruling.

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

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

- 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.

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

33. As the eligible service period in relation to the deductible interest payment for the PL 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 Investors who are STS taxpayers for the year of income, or to Investors who are individuals and the expenditure is not incurred in carrying on a business. Investors who satisfy these tests will be able to claim an immediate deduction for the interest charge allowable under section 8-1 of the ITAA 1936 incurred under the PL.

Sections 82KZMA and 82KZMD of the ITAA 1936: prepaid non-business expenditure incurred by non-individual and non-STS taxpayers

34. Section 82KZMD sets the amount and timing of deductions for expenditure for an Investor (other than an STS taxpayer for the year of income) that is not an individual and does not incur the expenditure in carrying on a business.

35. 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.

36. For these Investors, the allowable deduction for prepaid interest on the borrowings under the PL will be apportioned over the relevant interest payment period.

Section 110-25, section 110-55 and Division 134 of the ITAA 1997: Cost Base of Put Option

37. The Put Premium (see paragraph 17(b) of this Ruling) is included in the first element of the cost base and reduced cost base of the Put Option pursuant to subsections 110-25(2) and 110-55(2).

38. If the Put Option is not exercised, the Investor will make a capital loss, at the time the Put Option expires, equal to the reduced cost base of the Put Option (CGT event C2, paragraph 104-25(1)(c) of the ITAA 1997).

39. If the Put Option is exercised and title to the Protected Securities is transferred to Suncorp, any gain or loss on exercise of the Put Option is disregarded by virtue of subsection 134-1(4). The Investor will include the Put Premium in the cost base and reduced cost base of the Protected Securities (item 2 of the table in subsection 134-1(1)) for the purpose of working out any capital gain or capital loss under CGT event A1.

Part IVA of the ITAA 1936

40. Provided that the scheme ruled on is entered into and carried out as disclosed in this Ruling, it is accepted that the scheme is an ordinary commercial transaction and that Part IVA will not apply.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/33

Subject references

- debt deductions
- financial products
- interest expenses
- prepaid expenses
- product rulings
- public rulings
- small business Investor
- tax avoidance
- taxation administration

Legislative references:

- ITAA 1936 51AAA
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZL(2)(a)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA

- ITAA 1936 82KZMD
 - ITAA 1936 82KZME
 - ITAA 1936 82KZME(4)
 - ITAA 1936 82KZME(5)
 - ITAA 1936 82KZME(5)(b)(iii)
 - ITAA 1936 82KZMF
 - ITAA 1936 Pt IVA
 - ITAA 1997 8-1
 - ITAA 1997 104-10
 - ITAA 1997 104-25
 - ITAA 1997 110-25
 - ITAA 1997 110-25(2)
 - ITAA 1997 104-25(1)(c)
 - ITAA 1997 104-25(3)
 - ITAA 1997 110-55
 - ITAA 1997 110-55(2)
 - ITAA 1997 Div 134
 - ITAA 1997 134-1(1)
 - ITAA 1997 134-1(4)
 - ITAA 1997 Subdiv 328-F
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 - TAA 1953
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ATO references

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