


PR 2006/144 - Income tax: deductibility of interest incurred on borrowings in relation to the Macquarie Fusion Funds - November 2006 Offer

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Product Ruling

Income tax: deductibility of interest incurred on borrowings in relation to the Macquarie Fusion Funds – November 2006 Offer

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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. In this Ruling, the scheme is the investment in a Macquarie Fusion Fund using a loan made by Macquarie Bank Ltd (the Bank); a further borrowing from the Bank, if it occurs, used to fund a payment of interest; and the grant of a put option (Put Option) by the Bank.
2. This Ruling does not deal with the tax consequences of:
 - using a Profit Loan;
 - acquiring a Put Option without also drawing down an Investment Loan; and
 - fees paid by a Fusion Fund – Equity Trust or the Fusion Fund – Cash Trust.

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 104-25 of the ITAA 1997;
 - section 110-25 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

4. The class of entities to whom this Ruling applies is those who enter into the scheme described below on or after the date this Ruling is made with the 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 'Investor(s)'.

Qualifications

5. The Commissioner rules on the precise scheme identified in the Ruling. 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 17 of this Ruling.

6. 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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Robert Garran Offices
National Circuit
Barton ACT 2600

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Date of effect

8. This Ruling applies prospectively from 4 October 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.

9. 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 provision(s) ruled upon, to all persons within the specified class who enter into the specified scheme during the term of the Ruling. Thus, the Ruling continues to apply to those persons, 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 persons' involvement in the scheme.

Scheme

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

- application for a Product Ruling dated 16 August 2006 received from Macquarie Financial Products Management Limited as responsible entity (Responsible Entity or RE) for the Fusion Fund – Equity Trusts and the Fusion Fund – Cash Trust;
- draft Product Disclosure Statement for the Macquarie Fusion Funds (the PDS);
- Loan and Security Agreement (included in the PDS at section 12);
- Put Option Agreement (included in the PDS at section 13);

- Constitution for a Fusion Fund – Equity Trust (an Equity Trust). The constitution for each Equity Trust is the same in all material respects other than the description of the Underlying Managed Fund into which the Equity Trust will invest; and
- Constitution for the Fusion Fund – Cash Trust (the Cash Trust).

14. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, to which an Investor, or any associate of an Investor, will be a party.

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

- (a) an investment in a Macquarie Fusion Fund involves the subscription for units in one of a number of Equity Trusts together with the subscription for corresponding units in the Cash Trust. The combined investment in an Equity Trust and the Cash Trust is referred to as units in a 'Fund';
- (b) Investors subscribe for units in a Fund pursuant to the PDS. Investors will initially be required to invest 99.99% of their investment amount in one or more Equity Trusts and 0.01% of their investment in the Cash Trust;
- (c) all units in an Equity Trust will be issued at a price based on the prevailing net asset value of that Equity Trust and will be issued as fully paid units;
- (d) each Equity Trust will invest all application monies in an existing Australian public unit trust or a portfolio of Australian public unit trusts (Underlying Managed Fund). Each Equity Trust will invest in a different Underlying Managed Fund. The Underlying Managed Funds are not listed on any stock exchange;
- (e) all units in the Cash Trust will be issued as partly paid units with a paid up amount of \$0.0001 and an effective unpaid amount of \$1.4999;
- (f) the Cash Trust will be divided into pools of assets (Property Pools), each consisting of fixed term deposits or similar investments. There will be a different Property Pool for each class of units in the Cash Trust. Each class of unit will correspond to units in an Equity Trust issued on particular dates. All units in a particular class will have identical rights to the income and capital of the Property Pool to which that class relates;

- (g) the RE will manage an Investor's investment in the Equity Trust and the Cash Trust according to a technique known as 'Threshold Management'. This technique attempts to achieve the result that the value of an Investor's combined investment in the Equity Trust and the Cash Trust, including units acquired by the reinvestment of income, at the conclusion of the period ending 30 June 2012 (the Threshold Management Period) will be at least equal to the amount of their combined initial investment. The achievement of that result is, however, not guaranteed;
- (h) under Threshold Management, if the value of an Investor's units in a Fusion Fund falls below a sell trigger the Investor is deemed to have given a redemption request in respect of some of the Investor's units in the Equity Trust. The RE will redeem some of the Investor's units in that Equity Trust and apply the proceeds of that redemption to further pay up an amount on that Investor's corresponding units in the Cash Trust;
- (i) alternatively, if the value of an Investor's units in a Fusion Fund rises above a buy trigger, the RE may make a return of capital on the Investor's units in the Cash Trust and apply the proceeds to subscribe for further units in the corresponding Equity Trust on behalf of the Investor. This return of capital increases the amount which the RE, in accordance with Threshold Management, can call up on those units at a later time, hence fixing the effective maximum net paid up amount on the Cash Units at \$1.50 per unit;
- (j) the Equity Trust will invest all monies received pursuant to Threshold Management in the relevant Underlying Managed Fund;
- (k) the Cash Trust will invest all further amounts paid up in respect of its units pursuant to Threshold Management in fixed term deposits or similar investments;
- (l) the RE will be entitled to a fee for acting as responsible entity of each Equity Trust equal to a certain percentage per annum of the value of the assets of that Equity Trust. The RE will not be entitled to a fee for acting as responsible entity of the Cash Trust;
- (m) the distributable income of each Equity Trust and the Cash Trust for each year will be, at a minimum, the net income of the Equity Trust or Cash Trust determined in accordance with section 95 of the ITAA 1936 (less any amount included in net taxable income which is not yet received or receivable). Each Equity Trust and the Cash Trust will distribute all of its distributable income each year;

- (n) in the exercise of Threshold Management, the RE may require an Investor to reinvest some or all of their distribution or redemption payments into new units in the Equity Trust or into capital subscriptions to further pay up units in the Cash Trust;
- (o) each Equity Trust and the Cash Trust will be an open-ended trust with a termination date no later than 80 years from its commencement;
- (p) none of the Equity Trusts nor the Cash Trust will be listed;
- (q) there are three credit facilities available to finance an investment in a Fund. The two credit facilities subject to this Ruling are an Investment Loan to enable Investors to fund the initial subscription for their units in a Fund and an Interest Loan which allows the Investor to fund all or part of the first full financial year's interest prepayment on the Investment Loan (if the Investor prepays that interest and wishes to take out an Interest Loan to fund that prepayment). Approved borrowers may be invited to apply for further Interest Loans to fund subsequent periods' prepaid interest obligations on their Investment Loans;
- (r) the Investment Loan will end on 30 June 2012 (the Maturity Date). The interest rate will be determined by the Bank prior to the drawdown of the Investment Loan and in some cases may be varied during the term of the Investment Loan;
- (s) an Investor has 3 interest rate and payment options:
 - (i) Variable
Interest is paid monthly in arrears for the term of the Investment Loan at an interest rate that may be varied each month. Investors who use this option may be given the choice to pay their interest annually in advance from 30 June 2007;
 - (ii) fixed to 29 June 2008
Interest is paid monthly in arrears for the period from drawdown of the Investment Loan until 29 June 2007 and thereafter annually in advance on each 30 June for the term of the Investment Loan at an interest rate which is fixed until 29 June 2008 and which may be varied each 30 June thereafter. Investors who use this option may be given the choice to pay their interest monthly in arrears from 30 June 2008; and

- (iii) fixed for the term

Interest is paid monthly in arrears for the period from drawdown to 29 June 2007 and thereafter annually in advance on each 30 June for the term of the Investment Loan at an interest rate which is fixed for the term;

- (t) an Investor may repay that Investment Loan from their own sources and continue to hold units in the Fund;
- (u) the interest rate on an Interest Loan will be determined by the Bank prior to drawdown of that loan. The term of an Interest Loan equals the term of the prepaid interest period on the Investment Loan and is limited to twelve months. An interest Loan is repayable by way of twelve monthly in arrears principal and interest repayments over the prepaid interest period on the Investment Loan immediately following the date the Interest Loan is borrowed. Under the Interest Loan there is no limitation on the recourse of the Bank. Repayment of the Interest Loan prior to its Maturity Date may incur break costs;
- (v) the Loan and Security Agreement provides for full recourse for the Bank in respect of the principal owing on an Investment Loan and an Interest Loan at the Maturity Date (or earlier if the loans become payable before the Maturity Date);
- (w) Investors may also be required to pay a loan establishment fee (Establishment Fee) to the Bank upon successful application for an Investment Loan;
- (x) Investors who borrow from the Bank will also be required to buy a Put Option from the Bank. The exercise price of the Put Option is the higher of the amount of the Investment Loan and the value of the Fusion Fund units at the Settlement Date of the option. If exercised, the Bank agrees to buy the Investor's units at the exercise price on the Settlement Date (expected to be on or soon after 30 June 2012). These proceeds are to be offset against the amounts outstanding on the Investment Loan; and
- (y) the cost of the Put Option (Protection Fee) is a fixed percentage of the Investor's initial investment amount and is payable either monthly in arrears or annually in advance to coincide with the interest payment obligations on the Investor's Investment Loan.

The Participants

16. Macquarie Financial Products Management Limited is the issuer of the PDS and the Responsible Entity. The Bank is the provider of the Investment Loans used to acquire the units in a Fund and also the Interest Loans used to fund any prepayment of interest in respect of the Investment Loan.

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

Ruling

18. Subject to paragraphs 2 and 19 of this Ruling:

- (a) the interest charge on an Investment Loan allowable under section 8-1 of the ITAA 1997 in a particular income year, is the amount of the sum of the interest charge and the Protection Fee (Total Cost), that does not exceed the lower of:
 - the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans – Fixed or Variable (as applicable) multiplied by the Investment Loan; or
 - the relevant percentage of the Total Cost, being 85% for the Investment Loan;
- (b) the difference between the Total Cost and the deductible amount as calculated in paragraph 18(a) of this Ruling, represents the payment for the Put Option (Put Premium) and is not deductible under section 8-1 of the ITAA 1997;
- (c) the interest charge on an Interest Loan used to fund any prepaid interest on the Investment Loan, when paid by the Investor, will be allowable as a deduction to the Investor under section 8-1 of the ITAA 1997 to the same extent that a deduction is allowable for the corresponding Investment Loan interest (as described in paragraph 18(a)), that is the lower of:
 - the Reserve Bank Bulletin Indicator Lending Rates for Personal Unsecured Loans – Fixed or Variable (as applicable) multiplied by the Interest Loan; or
 - the relevant percentage of the interest payable on the Interest Loan, being 85% for the Interest Loan;

The non-deductible portion of the interest on the Interest Loan represents a further payment of the Put Premium;

- (d) section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction for the interest allowable under section 8-1 of the ITAA 1997;
- (e) section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest allowable under section 8-1 of the ITAA 1997;
- (f) section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the prepaid interest allowable under section 8-1 of the ITAA 1997 in respect of borrowings under an Investment Loan;
- (g) section 82KZM of the ITAA 1936 will not apply to deny an Investor immediate deductibility of the prepaid interest on an Investment Loan allowable under section 8-1 of the ITAA 1997 where at least one of the following applies for the year of income:
 - the Investor is an STS taxpayer; or
 - the Investor is an individual who does not incur that expenditure in carrying on a business;
- (h) sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for prepaid interest on borrowings under an Investment Loan that is allowable 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;
- (i) if the Investor exercises the Put Option, the Put Premium will form part of the cost base and the reduced cost base of the Investor's units in the Fund under section 134-1 of the ITAA 1997. Any gain or loss on exercise of the Put Option will be disregarded;
- (j) if the Put Option is not exercised, the Put Premium will form part 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;
- (k) CGT event C2 will occur under section 104-25 of the ITAA 1997 if the Investor does not exercise the Put Option and it expires. The Investor will make a capital loss equal to the reduced cost base of the Put Option;
- (l) the Establishment Fee paid, if applicable, is deductible under section 25-25 of the ITAA 1997; and
- (m) the anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny the deductibility of the interest incurred by the Investor in respect of borrowings under an Investment Loan or an Interest Loan.

Assumptions

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

- (a) the Investor is an Australian resident for taxation purposes;
- (b) the dominant purpose of the Investor in entering into the scheme is to derive assessable trust income or both assessable trust income and a capital gain from their investment in a Fund;
- (c) the Investors are not traders in investments and are not treated for taxation purposes as trading in interests in a Fund, carrying on a business of investing in a Fund, or holding their interests in a Fund as trading stock or as a revenue asset;
- (d) in respect of any interest amounts paid in advance under the Investment Loan, these may be prepaid, but only in relation to a payment period of 12 months or less that ends on or before the last day of the income year following the expenditure year;
- (e) the scheme will be executed in the manner described in the 'Scheme' section of this Ruling;
- (f) all dealings between the Investors and a Fund will be at arm's length;
- (g) at the time of the prepayment each of the two unit trusts comprising a Fund will have at least 300 unitholders;
- (h) neither the Investment Loan nor the Interest Loan will extend beyond their original maturity dates; and
- (i) the Investors will not repay the Investment Loan or the Interest Loan prior to their maturity or terminate the scheme early.

Commissioner of Taxation

4 October 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

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

21. Investors should only claim deductions for an amount of the sum of the interest charge on an Investment Loan and the Protection Fee, that does not exceed the amount described in paragraph 18(a) of this Ruling.

22. The difference between the Total Cost and the deductible amount as calculated in paragraph 18(a) of this Ruling is allocated to the cost of acquiring the Put Option. The Put Option ensures that the Investor is protected from liability to repay the Investment Loan if the value of the Investor's units in the Fund applicable to that loan fall below the amount borrowed under that loan. The Put Premium is a capital protection fee and is not deductible under section 8-1 of the ITAA 1997.

23. Interest on an Interest Loan, when paid by the Investor, is deductible under section 8-1 of the ITAA 1997 to the same extent that a deduction is allowable for the corresponding Investment Loan interest (as described in paragraph 18(c) of this Ruling). The non-deductible portion of the interest on the Interest Loan is also a payment of the Put Premium and is not deductible under section 8-1.

Section 51AAA of the ITAA 1936

24. Under the scheme, it is contemplated that over the period of an Investor's involvement there will be assessable income derived by way of distributions of the net income of a Fund and net capital gains. As the allowable interest on each of an Investment Loan and an Interest Loan will be deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to an Investor.

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 of the ITAA 1936. 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 Investor is an 'STS taxpayer', whether the Investor is an individual and whether the Investor 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 taxpayers

27. 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.

28. 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 businesses 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 prepaid interest charges on the Investment Loan allowable under section 8-1 of the ITAA 1997 are 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, which is 12 months, and not to the period of the loan (which is five years for an Investment Loan).

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

30. The rules in sections 82KZME and 82KZMF apply of the ITAA 1936, 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 of the ITAA 1936, 'agreements' are broadly defined to include an entire scheme of which a contract may form part. Under subsection 82KZME(4), the relevant 'agreement' is all the contractual schemes and activities associated with the participation in a Fund, including the financing and management schemes.

32. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude the interest allowable under section 8-1 of the ITAA 1997 incurred on borrowings under the Investment Loan from the operation of section 82KZMF as:

- the documents and facts described in the scheme at paragraphs 13 to 17 of this Ruling establish that Investors have fixed entitlements to all of the income and capital of an Equity Trust and the Cash Trust. Therefore, the prepaid interest allowable under section 8-1 is incurred in respect of money borrowed to acquire units in a widely held trust as described in subparagraph 82KZME(5)(b)(iii);
- the Investor can reasonably expect to obtain 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 scheme are at arm's length.

Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 33 to 38 of this Ruling.

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

33. Section 82KZM of the ITAA 1936 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.

34. The expenditure must not be excluded expenditure and must be incurred otherwise than in carrying on a business. Section 82KZM of the ITAA 1936 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.

35. As the eligible service period in relation to a deductible interest prepayment under an Investment Loan is not longer 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 of the ITAA 1936 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 allowable under section 8-1 of the ITAA 1997 incurred under an Investment Loan.

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

36. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure for a taxpayer (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.

37. 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.

38. For these Investors, the deduction for prepaid interest on the Investment Loan 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 the Put Option

39. If the Investor does not exercise the Put Option, the Put Premium will form the first element of the cost base and reduced cost base of the Put Option under subsections 110-25(2) and 110-55(2) of the ITAA 1997. 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).

40. If the Investor exercises the Put Option and transfers title to their units in the Fund to the Bank, any gain or loss on exercise of the Put Option is disregarded by virtue of subsection 134-1(4) of the ITAA 1997. The Investor will include the Put Premium in the cost base and reduced cost base of the units in the Fund disposed of to the Bank (subsection 134-1(1), item 2 of the ITAA 1997) for the purpose of calculating any capital gain or capital loss under CGT event A1.

Section 25-25 of the ITAA 1997: Establishment Fee

41. The Establishment Fee, if applicable, incurred by an Investor upon successful application for an Investment Loan will be an allowable deduction pursuant to section 25-25 of the ITAA 1997. The Establishment Fee will be deductible on a straight line basis over the period of the shorter of:

- the term of the Investment Loan; or
- five years.

Part IVA of the ITAA 1936

42. Provided that the scheme ruled on is entered into and carried out as described (see the Scheme section of this Ruling), it is accepted that the scheme is an ordinary commercial transaction and that Part IVA of the ITAA 1936 will not apply.

Appendix 2 – Detailed contents list

43. 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:

- financial products
- interest expense
- interest income
- prepaid expenses
- product rulings
- public rulings
- taxation administration

Legislative references:

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