



PR 2007/26 - Income tax: deductibility of interest incurred on borrowings in relation to the Macquarie Fusion Funds - June 2007 Offer

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 This document has changed over time. This is a consolidated version of the ruling which was published on *20 March 2013*



Product Ruling

Income tax: deductibility of interest incurred on borrowings in relation to the Macquarie Fusion Funds – June 2007 Offer

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❗ 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.

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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. 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.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product 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 Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling section (below) apply to the defined class of entities, who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.
2. 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 payment of a put option (Put Premium); and the grant of a put option (Put Option) by the Bank.
3. 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.

Class of entities

4. The class of entities who can rely on this Product Ruling consists of those entities that are accepted to participate in the scheme specified below on or after 28 March 2007, the date this Product Ruling is published and which execute relevant agreements mentioned in paragraph 16 of this Ruling on or before 29 June 2007. They must have a purpose of staying in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement. These entities are referred to as the Investor(s).

Qualifications

5. The class of entities defined in this Product Ruling may rely on it provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 19 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product 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 Product Ruling may be withdrawn or modified.

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Date of effect

8. This Product Ruling applies prospectively from 28 March 2007, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 28 March 2007 until 29 June 2007. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

9. However, the Product Ruling only applies to the extent that:

- there is no change in the scheme or in the entity's involvement in the scheme;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. 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)).

11. 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.

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).

Changes in the law

12. Although this Product Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of the Ruling and, to that extent, this Product Ruling will have no effect.

13. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

14. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Ruling

15. Subject to the assumptions in paragraph 20 of this Ruling:
- (a) the interest charge on an Investment Loan allowable under section 8-1 in a particular income year is the amount of the sum of the interest charge and the cost of the Put Option, being the 'Protection Fee', (these two amounts constituting the '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 15(a) of this Ruling, represents the Put Premium and is not deductible under section 8-1;
 - (c) the interest charge on an Interest and Put Protection Fee Loan, when paid by the Investor, will be allowable as a deduction to the Investor under section 8-1 to the extent that the loan is used to fund any prepaid interest on the Investment Loan. The interest charge on an Interest and Put Protection Fee Loan will not be allowable as a deduction to the Investor under section 8-1 to the extent that the loan is used to fund the annual Protection Fee.
 - (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;¹ 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. 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 (under subsection 110-25(2)) and the reduced cost base (under section 110-55) of the Put Option. The non-deductible portion of the interest on the Interest and Put Protection Fee Loan will form part of the third element of the cost base of the Put Option (subsection 110-25(4)) but will not form part of the reduced cost base of the Put Option (subsection 110-55(3));

¹ For the income year beginning 1 July 2007 and later income years:

- the references to 'an STS taxpayer' or 'STS taxpayers' in paragraphs 27 and 36 of this Ruling should be read to mean 'a small business entity' (as defined in section 328-110) or 'small business entities', as appropriate; and
- the references to 'an STS taxpayer' in paragraphs 15(g), 15(h), 34 and 37 of this Ruling should be read to mean 'a small business entity that has not chosen to apply section 82KZMD of the ITAA 1936'.

- (k) a CGT event will occur under section 104-25 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 Loan Establishment Fee paid, if applicable, is deductible under section 25-25; 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 and Put Protection Fee Loan.

Scheme

16. The scheme that is the subject of this Product Ruling is described below. The scheme is incorporated within the following documents:

- Application for a Product Ruling received on 15 February 2007 from Macquarie Financial Products Management Limited as responsible entity (Responsible Entity or RE) for each Fusion Fund – Equity Trust (Equity Trust) and the Fusion Fund – Cash Trust (Cash Trust);
- draft Product Disclosure Statement for the Macquarie Fusion Funds received and dated 13 March 2007 (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 an Equity Trust. The constitution for each Equity Trust is the same in all material respects other than the description of the public unit trust or portfolio of Australian public unit trusts (Underlying Managed Fund) into which the Equity Trust will invest; and
- Constitution for the Cash Trust.

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

17. The documents listed in paragraph 16 of this Ruling are those that an Investor may enter into. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor or any associate of an Investor, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

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

Overview

19. Following is a summary of the scheme:

- (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 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 29 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) 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;
- (n) 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;
- (o) none of the Equity Trusts nor the Cash Trust will be listed;
- (p) there are three credit facilities available to finance an investment in a Fund. One is an Investment Loan to enable Investors to fund the initial subscription for their units in a Fund. The second is an Interest and Put Protection Fee Loan which allows the Investor to fund the interest prepayment on the Investment Loan and the cost of the Put Option for the first full financial year (if the Investor prepays that interest and wishes to take out an Interest and Put Protection Fee Loan to fund that prepayment and the Put Protection Fee).

Approved borrowers may be invited to apply for further Interest and Put Protection Fee Loans to fund prepaid interest obligations on Investment Loans in subsequent periods;

- (q) the Investment Loan will end on 29 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;
- (r) 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 2008;
 - (ii) fixed to 28 June 2008

interest is paid annually in advance on the 29 June 2007 and each 30 June thereafter, for the term of the Investment Loan at an interest rate which is fixed until 28 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 annually in advance initially on 29 June 2007 and thereafter on each 30 June for the term of the Investment Loan at an interest rate which is fixed for the term;

For Options (ii) and (iii) the interest for 29 June 2008 will be paid on 30 June 2008 one day in arrears. Under Option (ii) the interest rate applying to the prepayment on 30 June 2008 will also be the interest rate applying to the 29 June 2008;

- (s) an Investor may repay that Investment Loan from their own sources and continue to hold units in the Fund;

- (t) the interest rate on an Interest and Put Protection Fee Loan will be determined by the Bank prior to drawdown of that loan. The term of an Interest and Put Protection Fee Loan equals the term of the prepaid interest period on the Investment Loan and is limited to twelve months. An Interest and Put Protection Fee 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 and Put Protection Fee Loan is borrowed. Under the Interest and Put Protection Fee Loan there is no limitation on the recourse of the Bank. Repayment of the Interest and Put Protection Fee Loan prior to its maturity date may incur break costs;
- (u) the Loan and Security Agreement provides for full recourse for the Bank in respect of the principal owing on an Investment Loan at the Maturity Date (or earlier if the loans become payable before the Maturity Date);
- (v) Investors may also be required to pay a Loan Establishment Fee to the Bank upon successful application for an Investment Loan;
- (w) 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 29 June 2012). These proceeds are to be offset against the amounts outstanding on the Investment; and
- (x) the 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.

Assumptions

20. 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 and Put Protection Fee Loan will extend beyond their original maturity dates; and
- (i) the Investors will not choose to repay the Investment Loan or the Interest and Put Protection Fee Loan prior to their maturity or terminate the scheme early.

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

21. 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).

22. 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 15(a) of this Ruling.

23. The difference between the Total Cost and the deductible amount as calculated in paragraph 15(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 falls below the amount borrowed under that loan. The Put Premium is a capital protection fee and is not deductible under section 8-1.

24. The proportion of the interest incurred on an Interest and Put Protection Fee Loan that is used to pay interest on the Investment Loan will be deductible under section 8-1. The proportion of the interest incurred on an Interest and Put Protection Fee Loan that corresponds to that part of the loan that is used to pay the Protection Fee is not deductible under section 8-1.

24A. No part of the interest incurred by the Investor on the Interest and Put Protection Fee Loan for the income year, including the non-deductible portion, will be attributable to the Put Premium.

Section 51AAA

25. 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 and Put Protection Fee 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

26. The operation of section 82KL of the ITAA 1936 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

27. Subdivision H of Division 3 of Part III of the ITAA 1936 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 – STS taxpayers

28. 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.

29. 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.

Subdivision 328-C – small business entities for the purposes of Subdivision H

29A. Under section 328-110, an Investor carrying on a business in an income year will be a small business entity for that year (the current year) if:

- (a) the Investor carried on a business in the previous income year and the aggregated turnover for that year was less than \$2 million;
- (b) the aggregated turnover for the current year is likely to be less than \$2 million and, where the Investor carried on a business in each of the two previous income years, the aggregated turnover for each of those income years was less than \$2 million; or
- (c) the aggregated turnover for the current year, worked out as at the end of the year, is less than \$2 million.

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

30. 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 of Division 3 of Part III of the ITAA 1936, 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.

Sections 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ arrangements

31. The rules in sections 82KZME and 82KZMF of the ITAA 1936 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 of the ITAA 1936, ‘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 Fund, including the financing and management arrangements.

33. 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 of the ITAA 1936 as:

- the documents and facts described in the scheme at paragraphs 16 to 19 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 of the ITAA 1997 is incurred in respect of money borrowed to acquire units in a widely held trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- 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 34 to 39 of this Ruling.

Section 82KZM – prepaid expenditure incurred by STS taxpayers and individuals incurring non-business expenditure

34. 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.

35. 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.

36. 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 – prepaid non-business expenditure incurred by non-individuals and non-STS taxpayers

37. 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.

38. The expenditure must not be excluded expenditure and must be incurred in return for the doing of a thing under an agreement that is not to be wholly done within the expenditure year.

39. For these Investors, the deduction for prepaid interest on the Investment Loan will be apportioned over the relevant interest payment period.

Section 110-25 and Division 134 – cost base of the Put Option

40. If the Investor exercises the Put Option and transfers title to their units in the Fund to the Bank any capital gain or capital loss on exercise of the Put Option is disregarded. The second element of the Investor's cost base and the reduced cost base for the units in the Fund will include any payment the Investor made to acquire the option (the Put Premium) (subsection 134-1(1), item 2).

41. If the Investor does not exercise the Put Option, the Put Premium will form part of the cost base (under subsection 110-25(2)) and the reduced cost base (under section 110-55) of the Put Option. 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)).

41A. The non-deductible portion of the interest on the Interest and Put Protection Fee Loan will form part of the third element of the cost base of the Put Option (subsection 110-25(4)). It will not form part of the third element, or any other element, of the reduced cost base of the Put Option (subsection 110-55(3)).

Section 25-25 – Loan Establishment Fee

42. The Loan 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. The Loan 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

43. 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

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

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