PR 2008/35 - Income tax: Babcock and Brown Property Instalment Plan

Product Ruling

Income tax: Babcock and Brown Property Instalment Plan

Contents Para

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. 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 Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling part apply to the defined class of entities, who participate in the scheme to which this Product Ruling relates.

2. In this Product Ruling the scheme is referred to as the 'SPI Plan'.

3. This Ruling provides certainty as to the tax consequences of only certain aspects of entering into and participating in the SPI Plan. It does not address:

(a) the tax consequences for an entity that participates in the scheme and acquires legal title to the Property later than 10 years from the last June 20 preceding the date of the SPI Contract (see paragraphs 19 to 22 of this Ruling);

(b) the tax consequences for an entity that funds their participation in the scheme not from their own resources; and

(c) the capital gains tax (CGT) disposal event(s) applicable to an entity that participates in the scheme and acquires legal title to the Property.

Class of entities

4. The class of entities (referred to as Investors) who can rely on this Product Ruling consists of those entities that are accepted to participate in the scheme specified below on or after the date this Product Ruling is published and which execute the relevant agreements mentioned in paragraphs 19 to 22 of this Ruling on or before 30 June 2011. 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 in the form of rent from letting the Property to a third party or parties.

Superannuation Industry (Supervision) Act 1993

5. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office gives no assurance that the product is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this product may contravene the provisions of SISA 1993.

Qualifications

6. 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 19 to 22 of this Ruling.

7. 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.

Date of effect

9. This Product Ruling applies prospectively to the specified class of entities that enter into the scheme from 9 April 2008, the date this Ruling is published until 30 June 2011, being its period of application. 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.

10. 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.

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

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

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

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

Changes in the law

14. 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.

15. 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

16. 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.

Goods and Services Tax (GST)

17. All fees and expenditure referred to in this Product Ruling may include the GST where applicable. In order for an Investor to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

Ruling

18. Subject to the assumptions in paragraph 23 of this Ruling:

(a) The Investor will be assessable under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) on rent received from the letting of the Property to a third party.

(b) The Investor will be entitled to tax deductions under section 8-1 of the ITAA 1997 in relation to the Ownership Costs (such as, rates, levies, insurances, land tax etc) paid in relation to the Property.

(c) The Investor will be entitled to tax deductions under section 8-1 of the ITAA 1997 for the Occupation Fee paid.

(d) The Investor will be entitled to tax deductions under section 8-1 of the ITAA 1997 in relation to Rent (where applicable) paid to the Vendor under the Lease Agreement.

(e) The Investor will be entitled to tax deductions under section 8-1 of the ITAA 1997 in relation to the Vendor Finance Amount or Seller Finance Amount (where applicable) paid to the Vendor under the SPI Contract.

(f) Sections 82KZMA and 82KZMD of the *Income Tax Assessment Act 1936* (ITAA 1936) will apply to set the amount and timing of deductions for the Ownership Costs, Rent, Vendor Finance Amount and Seller Finance Amount that are deductible to an Investor.

(g) Based on the specific terms of the SPI Contract (if the Property is in Queensland) and the SPI Contract and Lease Agreement (if the Property is in New South Wales or Victoria), the Investor can deduct an amount under Division 43 of the ITAA 1997 for capital works on the Property for an income year (from the income year during which the Investor entered into the SPI Plan in respect of the Property unless and until the income year during which the Investor ceases to 'own' the Property, including on termination prior to completion of the SPI Contract in respect of the Property), provided the Investor uses their 'your area' in the income year for the purpose of producing assessable income (such as the intended derivation of rent from the letting of the Property to a third party or parties).

(h) The Investor will not generally be entitled to any decline in value deduction under Division 40 of the ITAA 1997 in respect of capital works on the Property. However, the Investor may be entitled to a decline in value deduction under Division 40 of the ITAA 1997 for an item included in the capital works on the Property, where the item is both plant and a depreciating asset, for an income year (from the income year during which the Investor first uses the item, or has it installed ready for use, for any purpose after the time when the Investor entered into the SPI Contract [if the Property is in Queensland] or the SPI Contract and Lease Agreement [if the Property is in New South Wales or Victoria] in respect of the Property unless and until the income year during which the Investor ceases to hold that depreciating asset, including on termination prior to completion of the SPI Contract in respect of the Property), provided the Investor holds that depreciating asset under an applicable item of the table in section 40-40 of the ITAA 1997 during the income year. For the period until either completion of the SPI Contract in respect of the Property or termination of that contract prior to completion, this means that the Investor must hold that depreciating asset during that period under item 6 of the table in section 40-40 of the ITAA 1997.

(i) Pursuant to section 109-5 of the ITAA 1997, the time of acquisition of the Property by the Investor for CGT purposes is the time that the SPI Contract is entered into.

(j) The Establishment Fee will be included in the CGT cost base of the Property under section 110-25 of the ITAA 1997 if the Property is located in New South Wales or Queensland. If the Property is located in Victoria, the Establishment Fee will be included in the CGT cost base of the lease for possession of the Property under section 110-25 of the ITAA 1997.

(k) A capital gain made by the Investor on the disposal of the Property will be a discount capital gain for the purposes of section 115-5 of the ITAA 1997, provided the SPI Contract was entered into at least 12 months before the disposal occurred and the disposal does not occur under an agreement made within 12 months of entering into the SPI Contract.

(l) The anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to deny deductibility of the Occupation Fee, Rent, Vendor Finance Amount or Seller Finance Amount incurred by an Investor in respect of the SPI Plan.

Scheme

19. The scheme that is the subject of this Product Ruling is described below. The scheme is incorporated within the following documents received by the Tax Office on 20 June 2007:

- Application for a Product Ruling;
- Draft Babcock and Brown Superannuation Property Instalment (SPI) Plan brochure current as at 1 May 2007;
- Draft Contract Terms Sheet and Special Conditions, clauses 30-52 (New South Wales/Strata/Master Version 1) – that forms part of the NSW Standard Real Estate Institute contract 2005 Edition;
- Draft Terms Sheet Valencia Master 2 – New South Wales (strata);
- Draft Lease for Possession of Property – New South Wales (Strata);
- Draft Terms Sheet and Special Conditions (Victorian/Strata/Master Version 1) – that forms part of the Victoria Standard Real Estate Institute Contract;
- Draft Contract General Conditions (clauses 1-13) – Victoria;
- Draft Lease for Possession of Property – Victoria (Strata), for Victorian properties;
- Draft QLD Standard Real Estate Institute of Queensland Contract 05/03 First Edition;
- Draft QLD Contract Special Conditions – that form part of the QLD Standard Real Estate Institute of Queensland Contract 05/03 First Edition, to accommodate the SPI structure;
- Draft QLD Early Possession Conditions – specifies the terms of early possession and forms part of the Contract of Sale; and
- Draft Loan Facility Agreement – SPI Plan.

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

20. The documents highlighted 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.

21. All Australian Securities and Investment Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of these agreements is summarised as follows.

Overview

22. Following is a summary of the scheme:

(a) The SPI Plan is an arrangement entered into by the trustee(s) of a complying superannuation fund that is a self managed fund (Investor) and the registered owner (the Vendor) of property (the Property) for the Investor to immediately acquire possessory rights in the Property and for legal title to pass to the Investor on settlement.

(b) The Investor is unrelated to the Vendor and Babcock & Brown Australia Pty Ltd (B&B) and its subsidiaries.

(c) B&B or one of its subsidiaries is the arranger of the SPI Plan and also the provider of a guarantee to the Investor.

(d) The Property is located in New South Wales, Victoria or Queensland and is a strata title unit or freehold land on which residential premises has been or will be constructed.

(e) The agreements entered into by an Investor will depend on whether the Property is located in New South Wales, Queensland or Victoria and the type of Property as follows:

(i) If the Property is in New South Wales, the Investor and the Vendor will enter into the:

- Draft NSW Standard Real Estate Institute contract 2005 Edition, Draft Terms Sheet Valencia Master 2 – New South Wales (strata) and the Draft Contract Terms Sheet and Special Conditions, clauses 30-52 (New South Wales/Strata/Master Version 1) (the SPI Contract); and

- Draft Lease for Possession of Property – New South Wales (Strata) (Lease Agreement).

(ii) If the Property is in Victoria, the Investor and the Vendor will enter into the:

- Draft Victoria Standard Real Estate Institute Contract, Draft Contract General Conditions (clauses 1-13) and the Draft Terms Sheet and Special Conditions (Victorian/Strata/Master Version 1) (the SPI Contract); and
- Draft Lease for Possession of Property – Victoria (Strata) (Lease Agreement).

(iii) If the Property is in Queensland, the Investor and the Vendor will enter into the Draft QLD Standard Real Estate Institute Contract 05/03 First Edition, Draft QLD Early Possession Conditions and Draft QLD Contract Special Conditions (the SPI Contract).

(f) Each SPI Plan has the following common characteristics:

(i) the Investor and the Vendor enter into a SPI Contract – pursuant to which:

- the Investor has the rights, benefits and obligations of ownership, but is not the registered owner of the Property as legal title does not pass until the full purchase price of the Property is paid;
- the Investor is not entitled to do capital works to the Property unless they are approved capital works;
- settlement of the Property must occur no later than ten years from the last June 20 preceding the date of the SPI Contract; and
- B&B will provide a guarantee to the Investor of the delivery of the documents of title at settlement, should the Vendor be unable to do so at the time of settlement.

(ii) The Investor has possession of the Property, is able to derive rental income from the Property and is responsible for all costs associated with possession of the property (for example, rates, levies, insurances, taxes, maintenance and repair costs and other outgoings) (Ownership Costs) in relation to the Property, pursuant to:

- if the Property is in New South Wales or Victoria – the Lease Agreement, which is entered into between the Investor and the Vendor at the same time as entering into the SPI Contract; or
- if the Property is in Queensland – a right of early possession granted under the SPI Contract.

(iii) Depending on the location of the Property, the Investor must make the following payments to the Vendor:

- an initial payment (referred to as a 'Deposit') upon entering into the SPI Plan, being an agreed percentage of the purchase price of the Property being between 20% and 33 1/3%, plus any duty payable on the SPI Contract – this is payable under the SPI Contract if the Property is in New South Wales, Victoria or Queensland;
- an amount based on the unpaid purchase price of the Property and calculated by reference to a benchmark interest rate and is set at a margin above the bank bill rate – this amount is either:
  - payable under the SPI Contract and is referred to as either:
    - the 'Vendor Finance Amount' if the Property is located in New South Wales; or
    - the 'Seller Finance Amount' if the Property is located in Queensland; or

- payable under the Lease Agreement and is referred to as 'Rent' if the Property is in Victoria.

This amount is prepaid for 12 months and payable upon entering into the SPI Contract or Lease Agreement, as the case may be, and on each June 20 subsequent to the date of the SPI Contract or Lease Agreement, as the case may be;

- a fee of $1,500 – this amount is referred to as the 'Establishment Fee' under the SPI Contract if the property is in New South Wales or Queensland, or under the Lease Agreement if the property is in Victoria;
- a fee of $100 per annum – if the Property is in New South Wales or Victoria – referred to as an 'Occupation Fee' and is payable annually under the Lease Agreement for the initial and each renewed term of the lease; and
- at settlement of the Property, any unpaid balance of the purchase price of the Property.

(iv) Regardless of the location of the Property, under the SPI Contract the Investor must pay B&B a 'Guarantee fee' of $10, for B&B to guarantee delivery of the documents of title which the Vendor is obliged to deliver at settlement.

(v) Regardless of the location of the Property, under the SPI Contract the Investor may pay an instalment of the purchase price each year on a set date and the amount of the instalment is at the discretion of the Investor, subject to it being a multiple of $10,000.

(vi) The following table summarises the payments to be made by an Investor which differ depending on the location of the Property:

Property location	Type of payment	Under which contract or agreement
New South Wales	Deposit	SPI Contract
	Vendor Finance Amount	SPI Contract
	Establishment Fee	SPI Contract
	Guarantee Fee	SPI Contract
	Occupation Fee	Lease Agreement
	Instalment of purchase price	SPI Contract
	Ownership Costs	Lease Agreement
	Unpaid balance of purchase price at settlement	SPI Contract
Victoria	Deposit	SPI Contract
	Rent	Lease Agreement
	Occupation Fee	Lease Agreement
	Establishment Fee	Lease Agreement
	Guarantee Fee	SPI Contract
	Instalment of purchase price	SPI Contract
	Ownership Costs	Lease Agreement
	Unpaid balance of purchase price at settlement	SPI Contract
Queensland	Deposit	SPI Contract
	Seller Finance Amount	SPI Contract
	Establishment Fee	SPI Contract
	Guarantee Fee	SPI Contract
	Instalment of purchase price	SPI Contract
	Ownership Costs	SPI Contract
	Unpaid balance of purchase price at settlement	SPI Contract

Assumptions

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

(a) each Investor is a trustee of a complying superannuation fund that is a self managed superannuation fund;

(b) each Investor is an Australian resident for taxation purposes;

(c) the dominant purpose of an Investor in entering into the scheme is to derive assessable income from their investment in the SPI Plan in the form of rent from letting the Property to a third party or parties;

(d) the Investor will not be treated for income tax purposes as either trading in the Property or carrying on a business of investing in the Property;

(e) the Investor intends to complete the SPI Contract by acquiring legal title to the Property no later than 10 years from the last June 20 preceding the date of the SPI Contract;

(f) neither the members of the Investor nor their associates will occupy the Property at any time before the SPI Contract is terminated or whilst the Investor is the registered owner of the Property;

(g) the scheme will be executed in the manner described in the 'scheme' section of this Ruling;

(h) at no time during the scheme will the Investor assign any right(s) arising from the agreement(s) referred to in paragraph 22 of this Ruling;

(i) all dealings between the Investor, B&B, the Vendor and tenants will be at arm's length;

(j) the capital works on the Property began after 30 June 1997; and

(k) the Vendor constructed the capital works on the Property (being land that it owned or leased) in the course of a business that included the construction and sale of capital works of that kind.

Commissioner of Taxation
9 April 2008

Appendix 1 – Explanation

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 6-5

24. Upon entering the SPI Contract or the Lease Agreement, as the case may be, the Investor has possession of the Property and has the right to lease it to a third party to derive rental income. The rent that the Investor receives from the third party tenant will be assessable to the Investor under section 6-5 of the ITAA 1997 as ordinary income in the income year in which it is received by the Investor or applied at the Investor's direction.

Section 8-1 of the ITAA 1997

25. An Investor enters into the SPI Contract for the purpose of deriving rental income from the Property, which is assessable as discussed in paragraph 24 of this Ruling. Expenditure incurred in relation to Ownership Costs of a revenue nature commonly related to rental properties will be deductible as they are incurred in the course of the production of assessable income in the form of rent. This expenditure is not of a capital or private nature.

26. An Investor is liable to pay an annual Occupation Fee to the Vendor under the Lease Agreement in some arrangements. This fee is a cost of holding the property and is incurred in gaining or producing the Investor's assessable income in the form of rent. Therefore, this expenditure will be deductible to the Investor. This expenditure is not of a capital or private nature.

27. An Investor is liable to pay an annual Vendor Finance Amount or Seller Finance Amount to the Vendor under the SPI Contract in some arrangements. This outgoing is incurred in gaining or producing the Investor's assessable income in the form of rent. Therefore, this expenditure will be deductible to the Investor. This expenditure is not of a capital or private nature.

28. An Investor is liable to pay an annual Rent to the Vendor under the Lease Agreement in some arrangements. This outgoing is incurred in gaining or producing the Investor's assessable income in the form of rent. Therefore, this expenditure will be deductible to the Investor. This expenditure is not of a capital or private nature.

29. The Investor's purpose of incurring the above costs is to enable it to participate in the SPI Plan, under which it can derive rental income from the Property before legal title has passed to it. Any disproportion between the amount of the outgoings and the amount of the rental income received will not cause deductions to be denied provided the assumptions listed in paragraph 23 of this Ruling are met.

Sections 82KZMA and 82KZMD

30. Section 82KZMD of the ITAA 1936 sets the amount and timing of deductions for expenditure incurred in an income year (the expenditure year) by an Investor (other than a small business entity that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure for the year of income) who is a taxpayer that is not an individual and does not incur the expenditure in carrying on a business.

31. Section 82KZMA of the ITAA 1936 requires that the expenditure be an allowable deduction under section 8-1 of the ITAA 1997, not be excluded expenditure and must be incurred in return for the doing of a thing under an agreement that it is not to be wholly done within the expenditure year.

32. Where section 82KZMA and 82KZMD of the ITAA 1936 apply, deductions are spread over the periods to which the expenditure relates (the eligible service period).

33. The Investor is not an individual and does not incur expenditure in carrying on a business. Therefore, the deduction for any prepaid Ownership Cost, Rent, Vendor Finance Amount, Seller Finance Amount and other outgoings that are not excluded expenditure, will be apportioned over the eligible service period to which the expenditure relates.

Division 43

34. The Investor can deduct an amount under Division 43 of the ITAA 1997 for capital works for an income year provided that the following requirements in subsection 43-10(2) of the ITAA 1997 are met:

(a) the capital works have a construction expenditure area;

(b) there is a pool of construction expenditure for that area; and

(c) you use your area in the income year in the way set out in Table 43-140 of the ITAA 1997 (current year use).

Construction expenditure area

35. Section 43-75 of the ITAA 1997 explains the circumstances where there is a construction expenditure area for capital works. As the Vendor incurred expenditure of a revenue, rather than capital, nature in respect of the construction of the capital works on the Property, there will be no construction expenditure area for the capital works on the Property (since there will be no construction expenditure as defined in section 43-70 of the ITAA 1997) unless subsection 43-75(3) of the ITAA 1997 is satisfied. The subsection provides that there is taken to be a construction expenditure area for capital works purchased by an entity from another entity if:

(a) the capital works would have had a construction expenditure area but for the fact that the other entity did not incur capital expenditure in constructing the capital works;

(b) the other entity is not an associate of the entity; and

(c) the other entity constructed the capital works on land that it owned or leased in the course of a business that included the construction and sale of capital works of that kind.

36. The first requirement of that subsection is that the Investor 'purchased' the capital works on the Property from the Vendor. Although, under the SPI Contract, legal title to the Property does not pass until settlement, Latham CJ stated in *O'Neill v. O'Connell* (1945) 72 CLR 101 at 109:

> But it is argued that a contract to purchase land is not a purchase of land within the meaning of the Regulations. The contention means that there is no purchase of land unless the contract to purchase is completed by conveyance or transfer. In my opinion this construction should not be adopted. It is an ordinary use of language to say that a man purchases land when he agrees to buy it.

37. Therefore, it is considered that for the purposes of subsection 43-75(3) of the ITAA 1997, the Investor has purchased the Property from the Vendor at the time of entry into the SPI Contract.

38. None of the parties to the SPI Contract are associates and the Vendor constructed the capital works on the Property (being land that it owned or leased) in the course of a business that included the construction and sale of capital works of that kind. Therefore, there is taken to be a construction expenditure area for the capital works on the Property for the benefit of the Investor under subsection 43-75(3) of the ITAA 1997.

Pool of construction expenditure

39. The second requirement under subsection 43-10(2) of the ITAA 1997 for a capital works deduction is that there is a pool of construction expenditure for the construction expenditure area. Subsection 43-85(1) of the ITAA 1997 provides that a pool of construction expenditure is so much of the construction expenditure incurred by an entity on capital works as is attributable to the construction expenditure area.

40. Subsection 43-85(2) of the ITAA 1997 provides that in a case where subsection 43-75(3) of the ITAA 1997 applies, it is assumed in applying subsection 43-85(1) of the ITAA 1997 that the expenditure incurred by the other entity (the Vendor) was capital expenditure. So there will be a pool of construction expenditure for the construction expenditure area for the capital works on the Property for the benefit of the Investor. However, any expenditure that is excluded under subsection 43-70(2) of the ITAA 1997 from being construction expenditure is excluded from that pool of construction expenditure.

You use 'your area' in the income year in a deductible way

41. The final requirement for a capital works deduction for an income year is that you use 'your area' in the income year in the way set out in Table 43-140 of the ITAA 1997. Subsection 43-115(1) of the ITAA 1997 provides that 'your area' is that part of the construction expenditure area that you 'own'.

42. In *Bellinz Pty Ltd v. FCT* (1998) 38 ATR 350, Merkel J (at 362-363) said in relation to the meaning of 'owner' for the purposes of former subsection 54(1) of the ITAA 1936 (deduction for depreciation of plant or articles 'owned' by a taxpayer), that a beneficial owner can be an owner and (citing *KLDE Pty Ltd v. Commissioner of Stamp Duties (Qld)* (1984) 155 CLR 288) that beneficial ownership of land passes to the purchaser under an unconditional contract of sale which is capable of specific performance, on the contract being entered into notwithstanding that the balance of the purchase price has not then been paid. On appeal, the Full Federal Court did not disagree with Merkel J's analysis.

43. Therefore, based on the specific terms of the SPI Contract, the Investor is considered for the purposes of subsection 43-115(1) of the ITAA 1997 to 'own' part of the construction expenditure area for the capital works on the Property from the time the SPI Contract is entered into. Therefore, the Investor has a 'your area' from that time unless and until the Investor ceases to 'own' the Property, including on termination prior to completion of the SPI Contract in respect of the Property.

44. The circumstances of the scheme require that the Investor use their 'your area' at some time in the income year for the purpose of producing assessable income (such as the intended derivation of rent from the letting of the Property to a third party or parties). This is because the table in section 43-140 of the ITAA 1997 requires that for any capital works begun after 30 June 1997 you must use 'your area' for the purpose of (a) producing assessable income or (b) carrying on research and development activities. Paragraph (b) is not relevant to the scheme because the Investor does not use their 'your area' for the purpose of carrying on research and development activities: see also section 43-195 of the ITAA 1997.

45. Therefore, the Investor can deduct an amount under Division 43 of the ITAA 1997 for capital works on the Property for an income year (from the income year during which the Investor entered into the SPI Plan in respect of the Property unless and until the income year during which the Investor ceases to 'own' the Property, including on termination prior to completion of the SPI Contract in respect of the Property), provided the Investor uses their 'your area' in the income year for the purpose of producing assessable income.

Division 40

46. As the Investor can deduct amounts under Division 43 of the ITAA 1997 for the capital works on the Property, or could deduct such amounts had the Investor used the capital works for the purpose of producing assessable income, subsection 40-45(2) of the ITAA 1997 denies the Investor a possible decline in value deduction under Division 40 of the ITAA 1997 in respect of those capital works (such as a building). However, since expenditure on plant is excluded from construction expenditure under paragraph 43-70(2)(e) of the ITAA 1997, the Investor may be entitled to a decline in value deduction under Division 40 of the ITAA 1997 for an item included in the capital works on the Property, provided the item is both plant and a depreciating asset. Hereafter, such depreciating assets are referred to as 'the relevant depreciating assets'.

47. An Investor will be entitled to decline in value deductions under Division 40 of the ITAA 1997 for the relevant depreciating assets that are 'held' by the Investor where the other conditions of the Division are met.

48. Broadly speaking, a 'depreciating asset' is defined in section 40-30 of the ITAA 1997 as an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used. Land is specifically excluded from the definition of a depreciating asset. Taxation Ruling TR 2004/16 sets out the Commissioner's view on the extent to which there is plant in a residential rental property, which is the type of property to which the scheme relates. See that Ruling and *Rental Properties 2006-07* (NAT 1729 – 6.2007), a guide issued by the Tax Office, for more details, including a list of more than 230 items commonly found in residential rental properties (such as carpets, curtains, hot water cisterns and kitchen stoves). That list sets out whether an item may be eligible for a capital works deduction under Division 43 of the ITAA 1997 or a decline in value deduction under Division 40 of the ITAA 1997 and, if the latter, also includes the Commissioner's determination of its effective life.

49. The table in section 40-40 of the ITAA 1997 identifies who 'holds' a depreciating asset. Item 6 of the table applies where:

(a) an entity has possession, or an immediate right to possession, of the depreciating asset combined with a right, the exercise of which would make them the asset's holder; and

(b) it is 'reasonable to expect' that the entity will become the asset's holder by exercising that right or that the asset will be disposed of at their direction and for their benefit.

50. Where the conditions set out in item 6 are satisfied, the entity is taken to hold the depreciating asset and the 'former holder' (usually the asset's legal owner) is specifically precluded from being the asset's holder.

51. Under the SPI Contract (if the Property is in Queensland) and the SPI Contract and Lease Agreement (if the Property is in New South Wales or Victoria), as the case may be, the Investor is provided with a right, as against the Vendor, to possess the relevant depreciating assets immediately and the right to acquire legal title to the relevant depreciating assets from the Vendor.

52. The remaining issues are whether it is 'reasonable to expect' that the Investor will become the relevant depreciating asset's holder by exercising the right to complete the SPI Contract and thereby acquiring legal title to the depreciating asset or that the relevant depreciating asset will be disposed of at their direction and for their benefit. Paragraph 30 of Taxation Ruling TR 2005/20 discusses the application of the phrase 'reasonable to expect' in item 6 in relation to hire purchase agreements relating to goods. It states that in making the assessment as to the future, the notional buyer must objectively determine the likelihood that they will acquire the goods, or that the goods will be disposed of at their direction and for their benefit.

53. It is not, however, reasonable to expect that the relevant depreciating assets will be disposed of at the direction and for the benefit of the Investor. The parties to the SPI Contract have agreed (clauses 34.2(f) (NSW), 14.2(f) (Qld) and 33.2(e) (Vic)) that specific provisions apply in the event that completion does not occur under the SPI Contract for any reason. The relevant clauses – clauses 50 (NSW), 25 (Qld), and 48 (Vic) – provide the Vendor with the option to either sell the Property to a third party or obtain a valuation of the current market value of the Property. So the relevant depreciating assets may not be disposed of in the event that completion of the contract does not occur and, even if they are, such a sale is not at the direction of the Investor. Further, the order in which the Vendor is required to make various payments from the sale proceeds or based on the valuation of the Property means that only some (and possibly none) of the sale proceeds or valuation amount are for the benefit of the Investor.

54. Whether it is reasonable to expect that an Investor will become the relevant depreciating asset's holder by exercising the right to complete the SPI Contract and thereby acquiring legal title to the depreciating asset will depend on the individual circumstances of each Investor. Based on paragraph 30 of TR 2005/20, factors that may be relevant, but not necessarily conclusive, for an Investor in objectively assessing this question include:

- independent assessments of the expected market value of the Property at the SPI Contract completion date as against the amount required to purchase the Property under the SPI Contract;
- the Investor's history in deciding to complete previous property purchases of a nature similar to the SPI Plan providing there is nothing to suggest this pattern will change; and
- any other relevant commercial considerations affecting the Investor's decision to complete the SPI Contract.

55. If Item 6 of the table in section 40-40 of the ITAA 1997 applies the Investor holds the relevant depreciating assets under that item from the time when the Investor enters into the SPI Contract (if the Property is in Queensland) or the SPI Contract and Lease Agreement (if the Property is in New South Wales or Victoria) in respect of the Property; until the requirements of Item 6 are no longer satisfied, including on completion of the SPI Contract in respect of the Property or on termination of that contract prior to completion; and no other entity will hold the relevant depreciating assets during that period.

56. If Item 6 of the table in section 40-40 of the ITAA 1997 is not satisfied for the Investor, then the Investor will not hold the relevant depreciating assets as there is no other item in that table that will apply to make the Investor the holder of the relevant depreciating assets prior to completion of the SPI Contract in respect of the Property. As such, the Investor would not be entitled to any decline in value deductions for the relevant depreciating assets for the period prior to that time.

57. The Investor will acquire legal title to the Property if and when the SPI Contract in respect of the Property is completed. From that time the Investor will hold the relevant depreciating assets under Item 10 of the table in section 40-40 of the ITAA 1997 unless and until that item no longer applies, including because the Investor ceases to be the legal owner of the relevant depreciating assets or because another item in that table applies to make someone else, and not the Investor, the holder of the relevant depreciating assets.

58. A deduction will not be available for a relevant depreciating asset under Division 40 of the ITAA 1997 until the start time of the depreciating asset for the Investor, which will be when the Investor first uses it, or has it installed ready for use, for any purpose after they start to hold it (see subsection 40-60(2) of the ITAA 1997).

59. The cost of a depreciating asset, which is a component in working out the amounts you can deduct for its decline in value, consists of two elements (see section 40-175 of the ITAA 1997). The first element is generally worked out as at the time when the taxpayer begins to hold the depreciating asset (see section 40-180 of the ITAA 1997). The first element of the cost for a relevant depreciating asset will be the amount the Investor is taken under section 40-185 of the ITAA 1997 to have paid to hold the asset. This will generally be the portion of both the deposit paid and the balance of the purchase price incurred by the Investor to hold the relevant depreciating asset (see item 1 and item 2 of the table in paragraph 40-185(1)(b) of the ITAA 1997). The second element of the cost of a relevant depreciating asset is the amount the Investor is taken to have paid to bring the asset to its present condition and location from time to time since the taxpayer started holding the asset (see section 40-190 of the ITAA 1997).

60. The deduction for the decline in value of a relevant depreciating asset must be reduced by the part of the asset's decline in value that is attributable to the Investor's use of the asset, or the Investor having it installed ready for use, for a purpose other than a taxable purpose (see subsection 40-25(2) of the ITAA 1997).

Section 109-5

61. Under section 109-5 of the ITAA 1997, provided the Investor acquires the Property under the SPI Contract, the time of acquisition of the Property is as follows:

- if the Property is in Victoria or New South Wales – the Investor will be taken to have acquired the Property from the time of entering into the SPI Contract. This is in accordance with the acquisition rule applicable to CGT event A1 (section 104-10 of the ITAA 1997) in subsection 109-5(2) of the ITAA 1997.
- if the Property is in Queensland – the Investor will be taken to have acquired the Property at the time the Investor first obtains the use and enjoyment of the Property which is also the time of entering into the SPI Contract. This is in accordance with the acquisition rule applicable to CGT event B1 (section 104-15 of the ITAA 1997) in subsection 109-5(2) of the ITAA 1997.

Section 110-25

62. The Establishment Fee that the Investor pays to the Vendor upon entering the:

- SPI Contract, in respect of Property in New South Wales or Queensland, represents an amount paid in respect of the acquisition of the Property. As such, the Establishment Fee is included in the first element of the cost base of the Property under section 110-25 of the ITAA 1997; or
- Lease Agreement, in respect of Property in Victoria, represents an amount paid in respect of the acquisition of the right to lease the Property. As such the Establishment Fee is included in the first element of the cost base of that lease under section 110-25 of the ITAA 1997.

Section 115-5 of the ITAA 1997

63. Under Division 115 of the ITAA 1997, a capital gain from the disposal of a CGT asset can be a discount capital gain if certain requirements are met. In accordance with section 115-5 of the ITAA 1997, any capital gain realised by an Investor on the disposal of the Property subsequent to its acquisition under the SPI Contract, will be a discount capital gain, provided the SPI Contract was entered into at least 12 months before the disposal occurred and disposal does not occur under an agreement made within 12 months of entering into the SPI Contract.

Part IVA

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

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2004/16; TR 2005/20

Subject references:

- capital gains tax
- deduction
- financial product
- instalment plan
- ordinary income
- superannuation fund

Legislative references:

- ITAA 1936 54(1)
- ITAA 1936 82KZMA
- ITAA 1936 82KZMD
- ITAA 1936 Pt IVA
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 Div 40
- ITAA 1997 40-25(2)
- ITAA 1997 40-30
- ITAA 1997 40-40
- ITAA 1997 40-45(2)
- ITAA 1997 40-60(2)
- ITAA 1997 40-175
- ITAA 1997 40-180
- ITAA 1997 40-185
- ITAA 1997 40-185(1)(b)
- ITAA 1997 40-190
- ITAA 1997 Div 43
- ITAA 1997 43-10(2)
- ITAA 1997 43-70
- ITAA 1997 43-70(2)
- ITAA 1997 43-70(2)(e)
- ITAA 1997 43-75
- ITAA 1997 43-75(3)
- ITAA 1997 43-85(1)
- ITAA 1997 43-85(2)
- ITAA 1997 43-115(1)
- ITAA 1997 43-140
- ITAA 1997 43-195
- ITAA 1997 104-10
- ITAA 1997 104-15
- ITAA 1997 109-5
- ITAA 1997 109-5(2)
- ITAA 1997 110-25
- ITAA 1997 Div 115
- ITAA 1997 115-5
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- SISA 1993

Case references:

- O'Neill v. O'Connell (1945) 72 CLR 101
- Bellinz Pty Ltd v. FCT (1998) 38 ATR 350; 98 ATC 4399
- KLDE Pty Ltd v. Commissioner of Stamp Duties (Qld) (1984) 155 CLR 288; (1984) 56 ALR 337; (1984) 58 ALJR 545; 84 ATC 4793; (1984) 15 ATR 1214

Other references:

- Rental Properties 2006-07 (NAT 1729 – 6.2007)

ATO references

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