



# ***PR 2009/21 - Income tax: tax consequences of investing in ANZ Protected Equity Leveraged Solutions II***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *21 September 2011*



## Product Ruling

### Income tax: tax consequences of investing in ANZ Protected Equity Leveraged Solutions II

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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.

**[Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

## No guarantee of commercial success

The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives 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. The Commissioner recommends 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

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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

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1. This Product 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 this scheme is referred to as ANZ Protected Equity Leveraged Solutions II (APELS II) offered by the Australia and New Zealand Banking Group Limited (ANZ), which is a financial product issued under the APELS II Information Memorandum (IM).
3. This Ruling does not address the consequences of:
  - (a) early termination of the Loan;
  - (b) using the Loan to finance the exercise price of employee options;
  - (c) Cash Settlement of the Put Option where the value of the Security is below the Protection Level on Maturity Date;
  - (d) roll-over of the Loan on maturity;
  - (e) the Top-up Facility;
  - (f) the Reset Facility;
  - (g) the Portfolio Adjustment Facility;
  - (h) buying or selling Options (other than the Put Option under the Loan and the rights under the Protected Reduced Rate Facility of the Loan); or
  - (i) acquiring a Loan in respect of a Parcel (or Parcels) of Securities that an Investor already holds;

which are described in the APELS II IM dated 29 April 2009 and as amended on 6 December 2010.

**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 the date this Product Ruling is published and which execute relevant Agreements mentioned in paragraph 15 of this Ruling on or before 30 June 2012. They must have a purpose of remaining 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 Investor/s.

4A. The class of entities who can rely on this Product Ruling does not include entities that are subject to Division 230 of the *Income Tax Assessment Act 1997* (ITAA 1997) in respect of this scheme. Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.

**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 15 to 19 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.

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## Date of effect

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9. This Product Ruling applies prospectively from 29 April 2009, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 29 April 2009 until 30 June 2012 being its period of application. This Product Ruling will continue to apply to those entities even after its period of application has ended for the scheme 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.

### Changes in the law

11. Although this Product Ruling deals with the income tax 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 this Product Ruling and, to that extent, this Product Ruling will have no effect.

12. 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

13. 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

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14. Subject to paragraph 3 of this Ruling and the assumptions in paragraph 19 of this Ruling:

- (a) The interest charge under the Loan reduced by an amount reasonably attributable to the cost of capital protection worked out under step 3 of the method statement in subsection 247-20(3) of the ITAA 1997, will be deductible under section 8-1 of the ITAA 1997.
- (b) under subsection 247-20(3) of the ITAA 1997, the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the interest charge under the Loan exceeds:

- where interest is charged on the Loan from ANZ at a fixed rate for all or part of the term of the Loan and that fixed rate is applicable to the Loan for all or part of the income year, the amount of the Loan multiplied by the sum of the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans and 100 basis points (the 'adjusted loan rate') at the time when the interest charge is first incurred during the term of the Loan, or the relevant part of the term (subsections 247-20(4) and (5)); and
  - where interest is charged on the Loan from ANZ at a variable rate for all or part of the term of the Loan and a variable rate is applicable to the Loan for all or part of the income year, the amount of the Loan multiplied by the average of the adjusted loan rates applicable during those parts of the income year when the Loan is at a variable rate (subsections 247-20(5) and (5A));
- (c) The amount reasonably attributable to the cost of capital protection as worked out under subparagraph 14(b) of this Ruling, is treated as the cost of the put option (Put Option) under subsection 247-20(6) of the ITAA 1997. This amount is not deductible under section 8-1 of the ITAA 1997.
- (d) Section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny deductibility of the interest charge allowable as a deduction under section 8-1 of the ITAA 1997.
- (e) Section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest charge allowable as a deduction 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 prepaid interest allowable as a deduction under section 8-1 of the ITAA 1997.
- (g) Section 82KZM of the ITAA 1936 will not apply to deny the Investor immediate deductibility of any part of the interest charge allowable as a deduction under section 8-1 of the ITAA 1997, where at least one of the following applies for the year of income:
- the Investor is a small business entity (as defined in subsection 328-110(1) of the ITAA 1997) that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure; or

- the Investor is an individual who does not incur the interest charge 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 the prepaid interest charge, allowable as a deduction under section 8-1 of the ITAA 1997 to an Investor (other than a small business entity for the year of income that has not chosen to apply section 82KZMD to the expenditure) who is a taxpayer that is not an individual and does not carry on a business.
- (i) If the Put Option is exercised and the Investor transfers the Security to ANZ at the end of the term of the product, the cost of acquiring the Put Option will be added to the cost base and reduced cost base of the Security under section 134-1 of the ITAA 1997. Any capital gain or capital loss on exercise of the Put Option will be disregarded.
- (j) If the Put Option is not exercised at the end of the term of the product, capital gains tax (CGT) event C2 happens pursuant to paragraph 104-25(1)(c) of the ITAA 1997, resulting in a capital loss equal to the reduced cost base of the Put Option under subsection 104-25(3) of the ITAA 1997.
- (k) For CGT purposes, the Investor's date of acquisition of their interest in the Security is the Commencement Date pursuant to subsection 109-5(2) of the ITAA 1997.
- (l) The cost base and reduced cost base that an Investor has in the Security will include the amount of the Loan used to finance the acquisition of the Security, and incidental costs of acquisition and disposal pursuant to sections 110-25 and 110-55 of the ITAA 1997 respectively.
- (m) Any capital gain realised by an Investor on the sale of a Security will be treated as a discount capital gain under section 115-5 of the ITAA 1997 where the Investor is an individual or a trust and the sale occurs more than 12 months after the Commencement Date.
- (n) Where the Investor repays the Loan and retains ownership of the Security, the payment of the amount by which the Closing Price of the Security exceeds the Cap Level on the Maturity Date will form part of the cost base of the Security pursuant to subsection 110-25(6) of the ITAA 1997.
- (o) The anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to deny deductibility of the interest incurred by the Investor in respect of the Loan.

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## Scheme

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15. 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 dated 23 December 2008;
- APELS II IM dated 29 April 2009 issued by ANZ and as amended 6 December 2010, which includes the Terms and Conditions of entering into APELS II; and
- Additional information and correspondence provided on 25 February 2009, 27 February 2009, 5 March 2009, 4 April 2009, 30 April 2010, 7 June 2010, 21 June 2010, 1 July 2010; 13 July 2010; 1 December 2010 and 6 December 2010.

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

16. 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.

17. Unless otherwise defined, capitalised terms in this Product Ruling take their meaning as per the IM. Any use of the singular also includes the plural unless otherwise specified.

## Overview

18. Following is a summary of the scheme:

- (a) APELS II consists of a limited recourse loan (Loan) from ANZ, used by the Investor to finance up to 100% of the purchase price of a Parcel of Australian Securities Exchange (ASX) listed shares, units or Clearing House Electronic Subregister System (CHES) Depositary Interests (CDIs).
- (b) The Investor selects from a range of shares, units or CDIs listed on the ASX that the ANZ has approved for inclusion in APELS II (Security). The Investor grants a mortgage to ANZ over the Security as security for the Loan.
- (c) An Investor must complete an Application Form.



- (d) An Investor who purchases multiple Parcels of Securities can apply a Portfolio investment structure (Portfolio), or where offered by ANZ, a Basket investment structure (Basket). A Portfolio consists of a separate Loan and separate Put Option for each Parcel of Securities. A Basket consists of only one Loan and one Put Option for the entire Basket.
- (e) The minimum loan amount for a Portfolio or Basket is \$500,000, subject to a minimum for each Parcel of Securities of \$100,000. There is no maximum loan amount.
- (f) Investors are required to open an ANZ bank account and an ANZ sponsored CHESS account as part of the initial application.
- (g) The Investor may elect to cap the level of capital growth in relation to a Parcel of Securities under a Portfolio, or a Basket (Cap Level). This feature allows an Investor to obtain a reduced rate of interest by agreeing to limit their entitlement to the capital growth of a Parcel of Securities under a Portfolio, or a Basket. The reduction in the interest rate will depend on the Cap Level. This is the Protected Reduced Rate Facility.
- (h) If an Investor's Application Form has been accepted, the Investor may then send a Transaction Request which specifies the Security they propose to acquire with the Loan, the proposed Cap Level, the proposed Protection Level (minimum 100% of the loan amount), the proposed maturity (maximum 5 years) and whether the Loan is at a fixed or floating rate.
- (i) Based on the requested parameters, ANZ may offer a Loan and quote a rate to the Investor.
- (j) The Loan is made on a limited recourse basis (up to the agreed level of protection) and the proceeds are used to purchase the Security, which is held by the Investor subject to the mortgage in accordance with the terms of APELS II. The Security is held by ANZ Securities Limited (or other Sponsoring Participant) as Sponsoring Participant for purposes of CHESS.
- (k) Interest on the Loan is payable annually in advance on the Commencement Date and on each anniversary of the Commencement Date (unless agreed otherwise with ANZ).

- (l) There will be a different interest rate applicable to each Parcel of Securities or Basket. However, where an Investor has acquired multiple Parcels of Securities and applied the Portfolio investment structure, ANZ may apply a single blended interest rate across all the Parcels of Securities held by that Investor. The single interest rate will be determined prior to the Loans being made available and will be reflective of the type and size of the Parcels of Securities chosen, the various Protection Levels (and Cap Levels, if relevant) chosen and the Maturity Dates chosen.
- (m) At the Maturity Date, the Investor can elect one of four options:
- exercise the Put Option, (and specify whether the Investor has elected Physical Settlement or Cash Settlement of the Put Option):
    - (1) If Physical Settlement is chosen, the Security will be transferred to ANZ for an amount equal to the Protection Level;
    - (2) If Cash Settlement is chosen, the Investor will keep the Security and will be required to pay to ANZ the Amount Outstanding. ANZ will be required to pay to the Investor the amount by which the Protection Level exceeds the Closing Price (if any);
  - keep the Security and repay the Loan using their own Funds;
  - authorise the Sponsoring Participant to sell the Security and apply the sale proceeds to reduce the Amount Outstanding owing by the Investor and ANZ to pay any excess to the Investor. If the sale proceeds are insufficient to cover the Amount Outstanding, the Investor must cover any shortfall;
  - subject to ANZ's approval, the Investor can roll-over the Loan on the terms specified by ANZ.
- (n) On Maturity, if the Closing Price of the Security or the Basket on the Maturity Date exceeds the Cap Level for the Security or Basket and ANZ exercises its right to require payment, then the Investor must pay to ANZ an amount equal to the excess of the Closing Price over the Cap Price.
- (o) A Deposit Account in APELS II does not earn any interest for the Investors.

## Assumptions

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

- (a) all Investors are Australian residents for taxation purposes;
- (b) the Security consists solely of ordinary shares in an ASX listed company or units in an ASX listed unit trust or ASX listed CDIs;
- (c) at all times during the arrangement, where the Security consists of units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (ca) at all times during the arrangement, where the underlying securities in the CDIs are shares in a company, the shares will satisfy the requirements of subparagraph 82KZME(5)(b)(ii) of the ITAA 1936;
- (cb) at all times during the arrangement, where the underlying securities in the CDIs are units in a unit trust, the trust will satisfy the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- (d) Investors hold the legal and (unless they are trustees) beneficial interest in the Security;
- (e) the Investors are not traders in investments and are not treated for taxation purposes as trading in the Security, carrying on a business of investing in the Security, or holding the Security as trading stock or a revenue asset;
- (f) in respect of any interest charges to be paid in advance under the product, these may be prepaid only in relation to a loan interest payment period of 12 months or less, and which ends on or before the last day of the income year following the expenditure year;
- (g) the dominant purpose of an Investor in entering the arrangement is to derive assessable income from their Security acquired under APELS II, comprising dividends or trust distributions and capital gains;
- (h) the arrangement will be executed in the manner described in the 'Scheme' section of this Product Ruling;
- (i) all dealings by the Investors and ANZ under the product will be at arms length.

## 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 and Division 247 – capital protected borrowings and deductibility of interest**

20. The interest paid on a borrowing used to acquire income producing assets such as shares, units in a unit trust or CDIs is generally treated as deductible under section 8-1 of the ITAA 1997 where it is expected that dividends, trust distributions or other assessable income would be derived from the investment (see Taxation Ruling TR 95/33). However, the ability to claim interest deductions may be subject to Division 247 of the ITAA 1997.

21. Division 247 of the ITAA 1997 limits the allowable deductions for expenditure incurred under a 'capital protected borrowing'. Broadly, a capital protected borrowing is created where an amount is borrowed under an arrangement where the borrower is protected against the fall in value of some specified shares, units or CDIs, where that borrowing is made for the purpose of investing in those shares, units or CDIs.

22. Division 247 of the ITAA 1997 applies to the Loan, as:

- (a) the Investor uses the Loan from ANZ to acquire ASX listed shares, units or CDIs; and
- (b) the Investor is protected against the fall in the market value of the Security.

23. Division 247 of the ITAA 1997 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a capital protected borrowing. Division 247 ignores any amount which is not in substance for capital protection or interest in calculating the cost of capital protection, pursuant to subsection 247-20(3) of the ITAA 1997.

24. There is a cost of capital protection in an income year if the aggregate of the interest on the amount borrowed exceeds the total interest that would have been incurred for the year if the interest rate on the amount borrowed had been the adjusted loan rate (as determined when the interest rate is fixed or, if the interest rate is variable, the average of the adjusted loan rates during the variable interest rate period).

25. As there is no separate charge payable by an Investor in APELS II for a put option, the cost of capital protection is the amount worked out under subsection 247-20(3) of the ITAA 1997.

26. For an Investor in APELS II, the Investor's Put Option is a capital asset. As the cost of capital protection is the cost of the Investor's Put Option, this expense is capital in nature. The interest charge on the Loan will be deductible under section 8-1 of the ITAA 1997 only to the extent that it is not for the cost of capital protection.

27. Where an Investor has acquired multiple Parcels of Securities (and applied the Portfolio investment structure) and ANZ has applied a single interest rate across all the Parcels of Securities held by the Investor, the investment will be treated as one arrangement for the purposes of Division 247 of the ITAA 1997. However, as there is a separate Put Option provided in respect of each Parcel of Securities, the cost of capital protection will need to be reasonably apportioned to each Put Option.

## **Section 51AAA**

28. By acquiring the Security, it is contemplated that an Investor will derive assessable income by way of the receipt of dividend income or trust distributions and capital gains. As interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to an Investor who enters into APELS II.

## **Section 82KL**

29. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient additional benefits will be provided to trigger the application of section 82KL. Section 82KL 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**

30. Subdivision H of Division 3 of Part III (Subdivision H) 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 the carrying on of a business, whether the Investor is a small business entity, 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 that are of a capital nature.

**Subdivision 328-C of the ITAA 1997– small business entities**

31. Under section 328-110 of the ITAA 1997, 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**

32. The interest charge on the Loan deductible under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is 12 months or less. Paragraph 82KZL(2)(a) of the ITAA 1936 provides that a payment of interest that is made in return for the making available of a loan principal is to be taken, for the purposes of Subdivision H, to be expenditure incurred under an agreement in return for the doing of a thing under the agreement for the period to which the interest payment relates. The eligible service period in relation to a payment of loan interest is determined by reference to the period to which the interest relates, and not to the period of the Loan.

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

33. 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’ style arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

34. 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) of the ITAA 1936, the relevant agreement is all the contractual arrangements and activities associated with the participation in APELS II, including the financing; share, unit or CDI acquisition; and share, unit or CDI disposal arrangements.

35. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude the amount allowable for interest on borrowings under the Loan from the operation of section 82KZMF of the ITAA 1936, as:

- (a) the prepaid interest expenditure under the Loan is incurred in respect of money borrowed to acquire the Security that is listed for quotation on the ASX as described in subparagraphs 82KZME(5)(b)(ii) and (iii) of the ITAA 1936;
- (b) the Investor can reasonably be expected to obtain dividends or trust distributions from the investment;
- (c) the Investor will not obtain any other kind of assessable income from the investment except for capital gains; and
- (d) all aspects of APELS II are at arm's length.

36. Deductibility of the prepaid interest must therefore be considered under the prepayment rules contained in paragraphs 37 to 42 of this Ruling.

## **Section 82KZM – prepaid expenditure incurred by certain small business entities and individuals incurring non-business expenditure**

37. 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:

- (a) a small business entity for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure; or
- (b) a taxpayer that is an individual and the expenditure is not incurred in carrying on a business.

38. 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.

39. As the eligible service period in relation to the deductible interest payment under the Loan is not more than 12 months and does not end after the last day of the year of income after the one in which the expenditure was incurred, section 82KZM of the ITAA 1936 will have no application to Investors who are a small business entity for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or to Investors who are individuals where 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 the Loan.

**Section 82KZMD – prepaid non-business expenditure incurred by non-individual and non-small business entities**

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

41. 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.

42. For these taxpayers, the amount allowable for prepaid interest allowable as a deduction under section 8-1 of the ITAA 1997 incurred under the Loan will be apportioned over the relevant interest payment period.

**Sections 110-25, 110-55 and 134-1 – cost base of the Investor's Put Option and the Security**

43. The cost of capital protection forms part of the cost base and reduced cost base of the Security pursuant to section 134-1 of the ITAA 1997 if the Put Option is exercised and the Investor transfers the Security to ANZ.

44. The cost of capital protection forms part of the reduced cost base of the Put Option under section 110-55 of the ITAA 1997 if the Put Option is not exercised.

45. The Investor's cost base and reduced cost base in the Security will include the amount of the Loan used to finance the acquisition of the Security and incidental costs incurred by the Investor in acquiring and disposing of the Security (this includes stamp duty and costs of transfer) under section 110-25 and 110-55 of the ITAA 1997 respectively.



## **Section 109-5 – time of acquisition**

46. For CGT purposes, the Investor's date of acquisition of their interest in the Security is the Commencement Date pursuant to subsection 109-5(2) of the ITAA 1997.

## **Sections 104-10, 104-25 and 134-1**

47. If the Put Option is exercised at the Maturity Date by transferring title to the Security to ANZ in satisfaction of the Loan, any gain or loss on exercise of the Put Option is disregarded (subsection 134-1(4) of the ITAA 1997). The Investor will include the cost base of the Put Option in the second element of the cost base and reduced cost base of the Security disposed to ANZ (item 2 of subsection 134-1(4)).

48. If the Put Option is not exercised at the Maturity Date, and the Loan is not rolled over, the Put Option expires and the Investor will make a capital loss at that time, equal to the reduced cost base of the Put Option (CGT Event C2, paragraph 104-25(1)(c) of the ITAA 1997).

49. The grant of a right by the Investor to ANZ under the Protected Reduced Rate Facility will not result in a capital gain or loss arising for the Investor.

50. If ANZ exercises the right, no CGT event will arise in respect of the Security which has been retained by the Investor in these circumstances. The amount paid by the Investor, that is the difference between the Closing Price of the Security or Basket on Maturity Date and the Cap Level, is capital expenditure made to preserve the Investor's title to the Security and will form part of the Investor's cost base in the Security (subsection 110-25(6) of the ITAA 1997). In the case of a Basket, the amount should be reasonably apportioned over each Security in the Basket.

## **Section 115-5 – discount capital gains**

51. Division 115 of the ITAA 1997 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5 of the ITAA 1997, any capital gain realised by an Investor on the sale of the Security will be treated as a discount capital gain where the Investor is an individual or a trust and has held the Security for more than 12 months.

## **Part IVA**

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

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

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*Subject references:*

- capital protected borrowings
- financial products
- interest expenses
- prepaid expenses
- product rulings
- public rulings
- taxation administration

*Legislative references:*

- |                                   |                          |
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| - ITAA 1936 51AAA                 | - ITAA 1936 82KZMF       |
| - ITAA 1936 82KL                  | - ITAA 1936 Pt IVA       |
| - ITAA 1936 Pt III Div 3 Subdiv H | - ITAA 1997 8-1          |
| - ITAA 1936 82KZL(1)              | - ITAA 1997 104-10       |
| - ITAA 1936 82KZL(2)(a)           | - ITAA 1997 104-25       |
| - ITAA 1936 82KZM                 | - ITAA 1997 104-25(1)(c) |
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NO: 2008/19256

ISSN: 1441-1172

ATOlaw topic: Income Tax ~~ Product ~~ finance