


# ***PR 2013/13 - Income tax and goods and services tax: consequences for a Seller and Buyer under a White Popi Option Agreement***

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## Product Ruling

# Income tax and goods and services tax: consequences for a Seller and Buyer under a White Popi Option Agreement

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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.

## **No guarantee of commercial success**

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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 provisions identified in the Ruling section 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 Product Ruling, the scheme involves the execution of an Option Agreement (White Popi – Single and Joint Owner), referred to as the Option Agreement in this Product Ruling, or an Option Agreement (White Popi – Single and Joint Owner – Lump Sum Version), referred to as the Option Agreement Lump Sum Version in this Product Ruling, offered by Popi Management Pty Ltd (Popi Management).
3. This Product Ruling does not address:
  - the tax consequences to arise under any Popi other than a White Popi;
  - the tax consequences to arise for a Nominated Resident;
  - the tax consequences to arise for a Nominee;
  - the tax consequences to arise in the event of a nomination, as described in paragraph 37 of this Product Ruling (except where specifically addressed in paragraphs 16(p) to (r), 58, 59 and 61 of this Product Ruling);
  - the tax consequences of borrowing to fund any payments required to be made under the Option Agreement or Option Agreement Lump Sum Version (as applicable) and/or the acquisition of the Property, including the deductibility of interest;
  - the application of the main residence exemption under Subdivision 118-B to the Seller upon sale of the Property;
  - the tax consequences to arise in accordance with Division 128 upon the death of the Seller or Buyer; and
  - whether the scheme constitutes a financial arrangement for the purposes of Division 230 (Taxation of financial arrangements).

**Class of entities**

4. This part of the Product Ruling specifies which entities can rely on the Ruling section of this Product Ruling and which entities cannot rely on the Ruling section. In this Product Ruling, those entities that can rely on the Ruling section are referred to as the Seller and the Buyer.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that execute the relevant agreements mentioned in paragraph 17 of this Product Ruling on or after the date this Product Ruling is published and on or before 30 June 2016.

6. The class of entities who can rely on the Ruling section of this Product Ruling does **not** include:

- entities that execute the relevant agreements mentioned in paragraph 17 of this Product Ruling before the date of this Product Ruling or after 30 June 2016;
- entities that execute an Option Agreement or Option Agreement Lump Sum Version in respect of a Popi other than a White Popi;
- entities that execute an Option Agreement or Option Agreement Lump Sum Version as a Nominated Resident;
- a Nominee;
- entities that trade in financial instruments and are treated for taxation purposes as trading in Options, carrying on a business of investing in Options and/or Properties, or holding the Options and/or Properties as trading stock or as revenue assets;
- any legal personal representative and/or beneficiary or beneficiaries in the estate of the Seller or Buyer who are taken to have acquired an asset of the Seller or Buyer in accordance with Division 128 upon the death of the Seller or Buyer; or
- entities that are subject to Division 230 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**

7. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Commissioner gives no assurance that the scheme 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 scheme may contravene the provisions of SISA.

## **Qualifications**

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 17 to 42 of this Ruling.

9. 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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11. This Product Ruling applies prospectively from 12 June 2013, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme between 12 June 2013 and 30 June 2016 inclusive, 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.

12. 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**

13. 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 this Product Ruling and, to that extent, this Product Ruling will have no effect.

14. 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**

15. 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 Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

**Ruling**

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16. Subject to paragraph 3 and the assumptions in paragraph 42 of this Ruling:

**The Seller**

- (a) Capital gains tax (CGT) event D2 under section 104-40 happens when the Seller grants the Option to the Buyer. The Seller's capital proceeds under section 116-20 from the grant of the Option will be the sum of the Upfront Option Fee, the Annual Option Fee and, under the Option Agreement Lump Sum Version only, the Lump Sum that the Seller receives, or is entitled to receive, from the Buyer in respect of the granting of the Option.
- (b) CGT event D2 under section 104-40 also happens when the Option the Seller has granted to the Buyer is extended. The Seller's capital proceeds under section 116-20 from the extension of the Option will be the Annual Option Fee that the Seller receives, or is entitled to receive, from the Buyer in respect of the extension of the Option.
- (c) The capital proceeds referred to in paragraphs 16(a) and (b) of this Product Ruling will be reduced to nil upon payment by the Seller of the Option Fee Refund or Option Fee and Capital Contribution Refund, as applicable (section 116-50).

- (d) Any capital gain made by the Seller under CGT event D2 from the grant or extension of the Option will be disregarded upon exercise of the Option by the Buyer (subsection 104-40(5)). The Seller's capital proceeds from the grant and extension of the Option (as per paragraphs 16(a) and (b) of this Product Ruling) will instead be included in the capital proceeds received by the Seller from the Buyer for the sale of the Property (section 116-65).
- (e) The disposal of the Property by way of sale by the Seller following exercise of the Option by the Buyer will give rise to a CGT event A1 under section 104-10. The time of this event is the Exercise Date, upon which the Contract for the Sale of the Property is entered into.
- (f) The Seller's capital proceeds under section 116-20 from the disposal of the Property will, in addition to those amounts referred to in paragraph 16(d) of this Product Ruling, include the Initial Value.
- (g) Any capital gain or capital loss made by the Seller under section 104-10 from the disposal of the Property will be disregarded if:
  - a. they acquired the Property before 20 September 1985 (paragraph 104-10(5)(a)); or
  - b. the Property was their main residence for the purposes of Subdivision 118-B.
- (h) Any capital gain realised by the Seller from the disposal of the Property that may not be disregarded in accordance with paragraph 16(g) of this Product Ruling will be treated as a discount capital gain pursuant to section 115-5 where the Seller has held the Property for at least 12 months (excluding the days of acquisition and disposal). A capital gain realised by the Seller from the granting or extension of the Option that may not be disregarded pursuant to subsection 104-40(5) will not be treated as a discount capital gain under section 115-5 (paragraph 115-25(3)(b)).
- (i) No goods and services tax (GST) is payable by the Seller on the supply of the Option or Property to the Buyer (section 40-1 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)).

**The Buyer**

- (j) Upon delivery of a completed and signed Notice to Exercise to the Seller, the Buyer's ownership of the Option comes to an end by being exercised. A CGT event C2 happens under section 104-25 at this time.

- (k) Any capital gain or capital loss made by the Buyer under this event on exercise of the Option will be disregarded and the amount that the Buyer paid for the Option or to extend the Option, being the Upfront Option Fee, the Annual Option Fee and, under the Option Agreement Lump Sum Version only, the Lump Sum, is added to the cost base and reduced cost base of the Property acquired (section 134-1).
- (l) The cost base and reduced cost base of the Property acquired by the Buyer includes the Initial Value paid, or required to be paid, by the Buyer, in addition to those amounts referred to in paragraph 16(k) of this Product Ruling (subsections 110-25(2) and 110-55(2)).
- (m) A CGT event C2 under section 104-25 will happen where the Buyer's ownership of the Option comes to an end by expiring unexercised, resulting in a capital loss under subsection 104-25(3) equal to the reduced cost base of the Option.
- (n) A CGT event C2 under section 104-25 will happen where the Buyer's ownership of the Option comes to an end by being cancelled pursuant to the receipt of an Option Fee Refund or Option Fee and Capital Contribution Refund, as applicable.
- (o) The Buyer will not make a capital gain or capital loss from the CGT event C2 referred to in paragraph 16(n) of this Product Ruling upon receipt of an Option Fee Refund under the Option Agreement, but will make a capital gain from that event upon receipt of an Option Fee and Capital Contribution Refund under the Option Agreement Lump Sum Version equal to the amount by which the Capital Contribution exceeds the Lump Sum (subsection 104-25(3)).
- (p) A nomination by the Buyer of another person (a Nominee) to exercise the Option will constitute a transfer or assignment of the Option and therefore a disposal of the Option by the Buyer to a Nominee under CGT event A1 when the executed Nomination Notice is delivered by the Buyer to the Seller (section 104-10).
- (q) The Buyer's capital proceeds under section 116-20 from the disposal referred to in paragraph 16(p) of this Product Ruling will be the Nomination Fee received, or entitled to be received, from the Nominee. The cost base and reduced cost base of the disposed Option will be the amount that the Buyer paid, or was required to pay, to acquire and extend it (see paragraph 16(k) of this Product Ruling).

- (r) Any capital gain realised by the Buyer from the disposal referred to in paragraph 16(p) of this Product Ruling will be treated as a discount capital gain pursuant to section 115-5 where the Buyer is an individual, a complying superannuation entity, or a trust and has held the Option for at least 12 months (excluding the days of acquisition and disposal). The Option is acquired by the Buyer when it is granted to them by the Seller (subsection 109-5(2)).
- (s) The acquisition of the Option and/or Property by the Buyer from the Seller is not a creditable acquisition on which input tax credits may be claimed.

### **Anti-avoidance provisions**

- (t) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to the Seller or Buyer in respect of their participation in the scheme described in paragraphs 17 to 42 of this Product Ruling.

## **Scheme**

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17. The scheme that is the subject of this Ruling is identified and described in the following documents:

- application for a Product Ruling as constituted by documents and information received on 9 October 2012, 24 October 2012, 25 October 2012, 19 November 2012, 11 April 2013, 29 April 2013 and 7 May 2013;
- **Option Agreement (White Popi – Single and Joint Owner)**, received on 7 May 2013;
- **Option Agreement (White Popi – Single and Joint Owner – Lump Sum Version)**, received on 7 May 2013;
- **Exclusive Listing Agency Agreement (NSW)**, received on 25 October 2012;
- **Exclusive Management Agreement (NSW)**, received on 25 October 2012;
- Popi Australia Pensioner Information Guide, received on 9 October 2012; and
- Popi Australia Investors Information Guide, received on 9 October 2012.

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

18. The documents highlighted in paragraph 17 of this Ruling are those that a Seller and Buyer will/may enter into or be a party to. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Seller or Buyer, or any associate of a Seller or Buyer, will be a party to, which are a part of the scheme. Capitalised terms have the meaning provided in the Option Agreement and/or the Option Agreement Lump Sum Version.

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

### **Overview**

20. The Seller is the Registered Proprietor of a residential property (the Property) wishing to generate cash flow to fund their retirement and, pursuant to an Exclusive Listing Agency Agreement entered into with Popi Management as exclusive agent on behalf of the Seller, has their Property listed with Popi Management for sale under the terms of an Option Agreement or Option Agreement Lump Sum Version.

21. The Buyer wishes to generate wealth through residential property investment and completes a POPI Investor Registration Form.

22. In order to facilitate the corresponding objectives of the Seller and the Buyer, they are brought together by Popi Management to enter into a White Popi utilising an Option Agreement or Option Agreement Lump Sum Version.

### **Option Agreement**

23. Under the Option Agreement the Seller grants an Option to the Buyer to buy the Property for the Purchase Price and otherwise in accordance with the Contract for the Sale of the Property annexed to the Option Agreement in consideration of the Buyer paying to the Seller:

- an Upfront Option Fee, deemed to be paid on the Date of the Agreement,<sup>1</sup> and
- an Annual Option Fee monthly in arrears beginning one month after the Date of the Agreement.

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<sup>1</sup> Popi Management is immediately entitled to this Upfront Option Fee in its capacity as Agent under the Exclusive Listing Agency Agreement.

24. The Expiry Date of the Option is twelve months from the Date of the Agreement or its extension, except where a Trigger Event Notice has been served by the Seller upon the Buyer in which case the Expiry Date is 180 calendar days after service of that Trigger Event Notice.

25. The Buyer has an annual right to extend the Option for a further period of twelve months and may exercise such right to the extension:

- via the delivery of a Notice to Extend to the Seller within 90 days prior to the Expiry Date; and
- upon payment to the Seller of the Annual Option Fee payable for the corresponding twelve month period.

26. Assuming the ongoing extension of the Option by the Buyer, the Annual Option Fee will cease to be payable upon the earlier of the date on which the first Trigger Event occurs (the Trigger Date) and 25 years after the Date of the Agreement. A Trigger Event means either the death of the Seller; or the Seller wanting or needing to sell the Property (Ceasing to Reside).

27. During the term of the Option Agreement the Seller remains in the Property and retains title in the Property and all the responsibilities associated with ownership of the Property. The Seller does, however, agree and acknowledge that the Property shall not be sold, transferred, assigned, mortgaged, pledged, charged or otherwise dealt with other than as expressly provided in the Option Agreement.

28. To facilitate the rights and obligations of the Seller under the Option Agreement (including the collection of the Annual Option Fee from the Buyer), the Seller appoints and grants to Popi Management exclusive rights as set out in the Exclusive Management Agreement executed by the two parties. In respect of the services performed by Popi Management under the Exclusive Management Agreement, Popi Management is entitled to a Management Fee monthly in arrears to be deducted from the Annual Option Fee payable to the Seller under the Option Agreement.

29. The Buyer has a number of rights during the Option Period, as set out in the Option Agreement, including the right to lodge a caveat over the Property.

30. The Seller (or their Power of Attorney and/or their Estate) is required to serve a Trigger Event Notice upon the Buyer within 60 days of the Trigger Date.

31. Where the Trigger Event occurs within 36 months of the Date of the Agreement (the Guarantee Period), the Buyer may serve a Notice of Refund upon the Seller within 120 days of receipt of the Trigger Event Notice from the Seller, requiring the Seller to refund the Upfront Option Fee and Annual Option Fee (Option Fee Refund). The Option Fee Refund is payable by the Seller to the Buyer under these circumstances within 180 days of the date of service of the Notice of Refund and the Option Agreement terminates upon payment of the Option Fee Refund by the Seller.

32. If, having been served with a Trigger Event Notice, the Buyer wishes to exercise the Option, they may do so by delivering a completed and signed Notice to Exercise within 180 days after service of the Trigger Event Notice.

33. Upon service by the Buyer of the Notice to Exercise:

- the Seller must execute the Contract for the Sale of the Property, deemed to be entered into by both parties on the date the Notice to Exercise is served (the Exercise Date); and
- the Seller is bound to sell and the Buyer is bound to buy the Property in accordance with the terms of the Contract for the Sale of the Property.

34. If the Option isn't exercised by the Buyer by the Expiry Date, then the Option expires worthless and the Option Agreement comes to an end.

35. The Purchase Price at which the Buyer buys the Property upon exercise of the Option is that sum stipulated in the Contract for the Sale of the Property, but can be no less than the Property's Initial Value. The Initial Value is the value agreed upon by the Seller and the Buyer at the time of executing the Option Agreement, being the balance sum due at settlement by the Buyer, and will generally reflect the market value of the Property or an amount close to the market value of the Property as at the Date of the Agreement.

36. Other than in circumstances where the Buyer nominates a Nominee to exercise the Option after receipt of a Trigger Event Notice, the difference between the Initial Value and the Purchase Price is inserted into the Contract for the Sale of the Property as being the Deposit and is acknowledged by the Seller as having been paid by the Buyer. The Deposit amount, however, is never actually paid by the Buyer to the Seller as it is representative of the capital growth in the Property since the Date of the Agreement that is foregone by the Seller in exchange for payment by the Buyer of the Annual Option Fee.

37. The Buyer may, for a Nomination Fee, nominate another person (a Nominee) to exercise the Option by delivering to the Seller a Nomination Notice completed and executed by both the Buyer and the Nominee. Upon delivery of the Nomination Notice the Nominee replaces the Buyer under the Option Agreement.

## **Option Agreement Lump Sum Version**

38. But for the features described below in paragraphs 39 to 41 of this Product Ruling, the Option Agreement Lump Sum Version generally operates as described in paragraphs 23 to 37 of this Product Ruling.

39. An Option Agreement Lump Sum Version will generally be executed where the Seller wishes to obtain an upfront lump sum payment (Lump Sum) as part of their objective to generate cash flow to fund their retirement. The Option to buy the Property under the Option Agreement Lump Sum Version is therefore granted by the Seller to the Buyer in consideration of the Buyer paying an Upfront Option Fee, Annual Option Fee and the Lump Sum to the Seller. The Lump Sum is payable by the Buyer on the Date of the Agreement.

40. The Guarantee Period is 60 months from the Date of the Agreement (instead of 36 months). Where the Trigger Event occurs within this Guarantee Period, the Buyer may serve a Notice of Refund upon the Seller within 120 days of receipt of the Trigger Event Notice from the Seller, requiring the Seller to refund the Upfront Option Fee, Annual Option Fee and the Capital Contribution (the Option Fee and Capital Contribution Refund). The Capital Contribution is the Lump Sum multiplied by the Lump Sum Multiplier of 1.5.

41. Whilst the Initial Value under the Option Agreement Lump Sum Version remains a value agreed upon by the Seller and the Buyer at the time of execution of the agreement and the balance sum due at settlement by the Buyer, it is reduced by the Capital Contribution in exchange for the receipt by the Seller of the Lump Sum.

## **Assumptions**

42. This Ruling is made on the basis of the following assumptions:
- (a) the Seller and the Buyer are Australian residents for taxation purposes;
  - (b) the Seller and the Buyer are not traders in financial instruments and are not treated for taxation purposes as trading in Options, carrying on a business of investing in Options and/or Properties, or holding the Options and/or Properties as trading stock or as revenue assets;
  - (c) the Property is residential premises (as defined in section 195-1 of the GST Act) used predominantly for residential accommodation;
  - (d) the Property is not commercial residential premises (as defined in section 195-1 of the GST Act); or new residential premises (as defined in section 40-75 of the

GST Act) not used for residential accommodation before 2 December 1998;

- (e) all dealings between the Seller, Buyer, Nominee and Popi Management will be at arm's length; and
- (f) the scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation referred to in paragraph 17 of this Ruling.

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**Commissioner of Taxation**

12 June 2013

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## Appendix 1 – Explanation

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**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.*

### **Application of the CGT provisions to the Seller and the Buyer**

#### **Section 108-5: CGT assets**

43. Under subsection 108-5(1) a CGT asset is any kind of property or a legal or equitable right that is not property. The Option granted by the Seller to the Buyer and the Property which may be acquired by the Buyer from the Seller upon exercise of the Option are both CGT assets according to the definition in subsection 108-5(1).

#### **Granting of the Option by the Seller**

44. The granting of the Option by the Seller to the Buyer to purchase the Property gives rise to a CGT event D2 in respect of the Seller (section 104-40). The Seller will make a capital gain from this CGT event if the capital proceeds from the grant of the Option are more than the expenditure incurred to grant it or, alternatively, a capital loss from this CGT event if those capital proceeds are less than the expenditure incurred to grant it (subsection 104-40(3)).

45. The Seller’s capital proceeds will be equal to the sum of the Upfront Option Fee, the Annual Option Fee and, under the Option Agreement Lump Sum Version only, the Lump Sum they receive, or are entitled to receive, in respect of the granting of the Option (section 116-20).

#### **Extension of the Option**

46. The annual extension of the Option granted to the Buyer by the Seller gives rise to a CGT event D2 in respect of the Seller (section 104-40). The Seller will make a capital gain from this CGT event if the capital proceeds from the extension of the Option are more than the expenditure incurred to extend it or, alternatively, a capital loss from this CGT event if those capital proceeds are less than the expenditure incurred to extend it (subsection 104-40(3)).

47. The Seller’s capital proceeds will be equal to the Annual Option Fee they receive, or are entitled to receive, in respect of the extension of the Option (section 116-20).

***Exercise of the Option by the Buyer***

48. Where the Buyer exercises the Option granted to them by the Seller by way of delivery of a completed and signed Notice to Exercise to the Seller, the Buyer's ownership of the Option ends. A CGT event C2 happens in respect of the Buyer at this time (paragraph 104-25(1)(e)) but any capital gain or capital loss made by the Buyer under this CGT event is disregarded (subsection 134-1(4)).

49. A capital gain made by the Seller from the grant or extension of the Option pursuant to CGT event D2 (as per paragraphs 44 and 46 of this Product Ruling) will also be disregarded upon exercise of the Option by the Buyer (subsection 104-40(5)).

***Disposal of the Property by the Seller***

50. The sale of the Property by the Seller gives rise to a CGT event A1 in respect of the Seller (section 104-10). The Seller will make a capital gain from this CGT event if the capital proceeds from the disposal of the Property are more than the Property's cost base or, alternatively, a capital loss from this CGT event if those capital proceeds are less than the Property's reduced cost base (subsection 104-10(4)).

51. The Seller's capital proceeds from the disposal of the Property will include the Initial Value (section 116-20). Pursuant to subsection 116-65(2), the Seller's capital proceeds from the disposal of the Property upon the exercise of the Option by the Buyer will also include any payment the Seller receives for granting or extending the Option (as per paragraphs 45 and 47 of this Product Ruling).

52. The Buyer's cost base and reduced cost base in the Property acquired from the Seller will include the Initial Value (subsections 110-25(2) and 110-55(2)). Pursuant to subsection 134-1(1), the first element of the Buyer's cost base and reduced cost base in the Property will also include the cost base of the Option (that is, the Upfront Option Fee, the Annual Option Fee and, under the Option Agreement Lump Sum Version only, the Lump Sum).

***Expiry of the Option***

53. If the Option is not exercised by the Expiry Date, the Option expires and the Buyer's ownership of the Option ends (CGT event C2, paragraph 104-25(1)(c)). The Buyer will make a capital loss at that time equal to the reduced cost base of the Option, calculated under section 110-55 to include the Upfront Option Fee, the Annual Option Fee and, under the Option Agreement Lump Sum Version only, the Lump Sum.

***Payment of an Option Fee Refund or Option Fee and Capital Contribution Refund by the Seller***

54. Where the Buyer receives, as applicable, an Option Fee Refund or an Option Fee and Capital Contribution Refund from the Seller, the Buyer's ownership of the Option ends. A CGT event C2 happens in respect of the Buyer at this time (paragraph 104-25(1)(a)). The Buyer will make a capital gain from this CGT event if the capital proceeds from the ending of the ownership of their asset are more than the asset's cost base or, alternatively, a capital loss is made from this CGT event if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3)).

55. The Buyer's capital proceeds upon receipt of an Option Fee Refund, that is, the sum of the Upfront Option Fee and the Annual Option Fee, will equal the cost base of the Option. The Buyer will therefore not make any capital gain or loss from a CGT event C2 that happens upon receipt of an Option Fee Refund.

56. The Buyer's capital proceeds upon receipt of an Option Fee and Capital Contribution Refund will be the sum of the Upfront Option Fee, Annual Option Fee and Capital Contribution (section 116-20). The cost base of the Buyer's Option will be the sum of the Upfront Option Fee, Annual Option Fee and Lump Sum that the Buyer paid in respect of acquiring it (subsection 110-25(2)). The Buyer will therefore make a capital gain from a CGT event C2 that happens upon receipt of an Option Fee and Capital Contribution Refund equal to the amount by which the Capital Contribution exceeds the Lump Sum (subsection 104-25(3)).

57. Pursuant to section 116-50, the capital proceeds from a CGT event are reduced by any part of them that are repaid. The capital proceeds received, or entitled to be received, by the Seller in respect of the granting or extension of the Option (as per paragraphs 45 and 47 of this Product Ruling) will therefore be reduced to nil upon any payment by them of the Option Fee Refund or Option Fee and Capital Contribution Refund, as applicable.

***Nomination of Nominee to replace the Buyer***

58. A transfer or assignment by the Buyer of the Option to a Nominee gives rise to a CGT event A1 in respect of the Buyer (section 104-10). The Buyer will make a capital gain from this CGT event if the capital proceeds from the disposal of the Buyer's Option are more than the Option's cost base or, alternatively, a capital loss from this CGT event if those capital proceeds are less than the Option's reduced cost base (subsection 104-10(4)).

59. The Buyer's capital proceeds will be the Nomination Fee they receive, or are entitled to receive, from the Nominee for the disposal (section 116-20). The cost base and reduced cost base of the Option will be as per paragraph 52 of this Product Ruling).

**Section 115-5: discount capital gains**

60. Division 115 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5, any capital gain realised by the Seller as a result of the disposal of the Property and which is not otherwise disregarded in accordance with paragraph 16(g) of this Product Ruling will be treated as a discount capital gain where the Seller has held that Property for at least 12 months (excluding the days of acquisition and disposal). Any capital gain realised by the Seller from the granting or extension of the Option will not be a discount capital gain (paragraph 115-25(3)(b)).

61. In accordance with section 115-5, any capital gain realised by the Buyer as a result of the disposal of the Option to a Nominee will be treated as a discount capital gain where the Buyer is an individual, a complying superannuation entity, or a trust and has held that Option for at least 12 months (excluding the days of acquisition and disposal).

**Application of the GST provisions to the Seller and the Buyer*****Supply of the Option and the Property by the Seller***

62. GST is not payable on a supply that is input taxed (section 40-1 of the GST Act). A supply is input taxed if it is input taxed under Division 40 of the GST Act; or it is a supply of a right to receive a supply that would be input taxed under Division 40 (subsection 9-30(2) of the GST Act).

63. Pursuant to the assumptions in paragraphs 42(c) and 42(d) of this Product Ruling, the supply of the Property by the Seller to the Buyer is input taxed in accordance with section 40-65 of the GST Act and therefore not one on which GST is payable by the Seller, nor one that gives rise to any entitlement to an input tax credit for anything acquired to make the supply.

64. Pursuant to the assumptions in paragraphs 42(c) and 42(d) of this Product Ruling, the supply of the Option by the Seller to the Buyer is a supply of a right to receive a supply of residential premises which would be input taxed under section 40-65 of the GST Act. The supply of the Option is therefore also input taxed under paragraph 9-30(2)(b) of the GST Act and not one on which GST is payable by the Seller, nor one that gives rise to any entitlement to an input tax credit for anything acquired to make the supply.

***Acquisition of the Option and the Property by the Buyer***

65. A creditable acquisition, on which entitlements to input tax credits arise pursuant to section 11-1 of the GST Act, can only be made if, inter alia, the thing supplied is a taxable supply (section 11-5 of the GST Act).

66. As the Option and the Property supplied to the Buyer are, for the reasons set out in paragraphs 63 and 64 of this Product Ruling, classified as input taxed supplies (rather than taxable supplies), they are not creditable acquisitions made by the Buyer. Therefore, the Buyer will not be entitled to claim input tax credits on these acquisitions.

#### **Part IVA – anti-avoidance**

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

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

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

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## References

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Not previously issued as a draft

*Subject references:*

- capital gains tax
- financial products
- goods and services tax
- income tax
- product rulings
- public rulings
- taxation administration

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