PR 2013/23 - Income tax: tax consequences for an investor in a Westpac Retirement Deposit

Product Ruling

Income tax: tax consequences for an investor in a Westpac Retirement Deposit

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, 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 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

This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant 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 is an investment in a Westpac Retirement Deposit (Deposit) offered by Westpac Banking Corporation (Westpac) under a Product Disclosure Statement.

3. This Product Ruling does not address the taxation consequences of:

- a transfer of a Deposit;
- terminating a Deposit before its Maturity Date; and
- borrowing funds to invest in a Deposit, including the deductibility of interest on funds borrowed to invest in a Deposit.

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 an investor.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those investors that are accepted to participate in the scheme described in paragraphs 16 to 30 of this Product Ruling on or after the date this Product Ruling is published and on or before 30 June 2016. They must have an intention of staying in the scheme until it is completed (that is, holding on to the Deposit until its Maturity Date).

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

- intend to terminate their involvement in the scheme prior to its completion;

- are accepted to participate in the scheme described in paragraphs 16 to 30 of this Product Ruling before the date of this Product Ruling or after 30 June 2016;
- trade in financial instruments or securities and are treated for taxation purposes as trading in Deposits, carrying on a business of investing in Deposits, or holding Deposits as trading stock or as revenue assets; or
- 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 16 to 30.

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.

Date of effect

10. This Product Ruling applies prospectively from 18 December 2013 the date it is published. It therefore applies only to the specified class of entities that enter into the scheme between 18 December 2013 and 30 June 2016, 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.

11. 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

12. Although this Product Ruling deals with the income tax and superannuation 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.

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

Note to promoters and advisers

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

Ruling

15. Subject to paragraph 3 of this Product Ruling and the assumptions in paragraph 30 of this Product Ruling:

(a) Each Interest Payment received by an investor in respect of their Deposit will be included in the assessable income of the investor under section 6-5 in the income year in which the Interest Payment is credited.

(b) The Deposits do not have an eligible return for the purposes of subsection 159GP(3) of the *Income Tax Assessment Act 1936* (ITAA 1936) and are not qualifying securities as defined under subsection 159GP(1).

(c) The Deposits are traditional securities as defined under subsection 26BB(1) of the ITAA 1936.

(d) Division 230 will not apply to any gains or losses from a Deposit held by an investor excepted from the Division pursuant to section 230-455.

(e) A Deposit is capable of being held by an investor who is a trustee of a complying superannuation fund paying an account-based pension as part of the fund's segregated current pension assets for the purposes of section 295-385.

(f) 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 ITAA 1936 will not apply to an investor.

Scheme

16. 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 19 October 2012, 12 November 2012, 21 December 2012 and 26 November 2013; and
- draft Product Disclosure Statement for the Deposits, received on 26 November 2013; and Product Disclosure Statement for the Deposits dated 1 November 2015.

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

17. 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 an investor, or any associate of an investor, will be a party to, which are a part of the scheme. Capitalised terms have the meaning provided in the Product Disclosure Statement.

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

19. The Deposits are only offered by Westpac in Australia to Australian residents such as trusts (including trustees of complying superannuation funds), individuals, incorporated bodies and unincorporated associations, and are described in the Product Disclosure Statement as term deposits designed to provide investors with a secure, regular income stream in the form of Retirement Deposit Payments for the Term of their investment.

20. An investor can tailor their Deposit by choosing:

(a) the amount to be invested in the Deposit (the Principal Amount), subject to a minimum, which will be invested/deposited by the investor on the Commencement Date;

(b) the Term of their Deposit, ranging from one year to fifteen years;

(c) the frequency on which the Retirement Deposit Payments will be made by Westpac, that is, monthly, quarterly, semi-annually or annually;

(d) the portion of the Principal Amount the investor wants to receive on the Maturity Date (the Residual Principal Amount), expressed as a percentage of the Principal Amount; and

(e) to receive a series of fixed Retirement Deposit Payments for the Term of the Deposit, referred to as a 'fixed payment Deposit' for the purposes of this Product Ruling; or Retirement Deposit Payments that are linked to inflation for the Term of the Deposit, referred to as an 'inflation adjusted Deposit' for the purposes of this Product Ruling.

21. After providing all of the information set out in paragraph 20 of this Product Ruling to Westpac, the investor will receive a quote and, if satisfied with that quote, must immediately confirm their acceptance of the offer and return the Application Form to Westpac. Upon Westpac's acceptance of a properly completed Application Form from the investor, the investor will be bound by the terms of their Deposit. Those terms cannot be varied from that point on.

22. Each Retirement Deposit Payment received by an investor over the Term includes an interest component (Interest Payment) and may include a principal component (Principal Payment).

23. As indicated at paragraph 20(d) of this Product Ruling, the investor can choose to receive all or part of the Principal Amount back on the Maturity Date by selecting a Residual Principal Amount of either 0%, 25%, 50%, 75% or 100%. Where the investor chooses a Residual Principal Amount of 0% to 75%, each Retirement Deposit Payment received by them over the Term will consist of both an Interest Payment and a Principal Payment. Where the investor selects to receive the entire Principal Amount back on the Maturity Date (that is, selects to have a Residual Principal Amount of 100%), each Retirement Deposit Payment received by them over the Term will only consist of an Interest Payment.

24. Westpac determines the interest rate paid on the Deposit (the Earnings Rate) and the Initial Retirement Deposit Payment on the basis of the choices made by the investor, as well as a variety of other factors, including prevailing market interest rates and inflation expectations (if applicable), and Westpac's profit margins.

25. Whilst the amount of the Retirement Deposit Payments under a fixed payment Deposit will be the same on every Payment Date throughout the Term, under an inflation adjusted Deposit the Retirement Deposit Payments may be adjusted on each anniversary for changes in the CPI using the following formula:

Initial Retirement Deposit Payment x [Current CPI / Base CPI]

where the Base CPI is the second last full quarter prior to the Commencement Date; and the Current CPI is the second last full quarter prior to each anniversary of the Deposit.

26. Where the CPI decreases, the investor's Retirement Deposit Payments under the inflation adjusted Deposit will reduce but can never be less than their Initial Retirement Deposit Payment.

27. Retirement Deposit Payments will be paid by Westpac in arrears for the period since the previous Payment Date (or the Commencement Date as the case may be). Westpac does not have the ability to defer any payment beyond the relevant Payment Date.

28. The investor may, at the discretion of Westpac, terminate their Deposit before its Maturity Date. In such circumstances, the investor may be required to make an early termination payment and the remaining Principal Amount will be returned to the investor. No other fees or charges are payable by the investor in respect of a Deposit.

29. The Deposits are not annuities for the purposes of the *Life Insurance Act 1995*, nor do they meet the annuity standards in the *Superannuation Industry (Supervision) Regulations 1994*.

Assumptions

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

(a) the investor is an Australian resident for taxation purposes;

(b) the investor is not a trader in financial instruments or securities and is not treated for taxation purposes as trading in Deposits, carrying on a business of investing in Deposits, or holding Deposits as trading stock or as revenue assets;

(c) the investor has not made an election under subsection 230-455(7) to have Division 230 apply;

(d) to the extent that the investor is a trustee of a superannuation fund paying a superannuation income stream benefit, the investor:

- holds, or otherwise deals with the investment solely to enable the discharge of all or part of their liabilities (contingent or not) in respect of those superannuation income stream benefits that are payable by the fund at the time of holding, and obtains before the date for lodgment of the fund's income tax return the required actuary's certificate (refer subsection 295-385(3)); or
- holds, or otherwise deals with the investment solely to enable the fund to discharge all or part of its liabilities (contingent or not) as they become due, in respect of superannuation income stream benefits that are payable by the fund at that time and are prescribed by the *Income Tax Assessment Regulations 1997* (ITAR 1997) for the purposes of section 295-385 (refer subsection 295-385(4)), where those liabilities at all times during the income year were liabilities in respect of prescribed superannuation income stream benefits (refer subsection 295-385(5));

(e) the market value of the assets held by the investor that is a complying superannuation fund to support the prescribed superannuation income stream benefit does not exceed the account balance supporting the benefit (refer subsection 295-385(6));

(f) investors that are complying superannuation funds are not prevented from making such an investment by any particular terms of the fund's trust deed, and are not in breach of any stated investment strategy of the fund;

(g) the scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation mentioned in paragraph 16 of this Product Ruling; and

(h) all dealings between the investor and Westpac will be at arm's length.

Commissioner of Taxation
18 December 2013

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.

Interest Payments assessable as ordinary income under section 6-5

31. Section 6-5 includes income according to ordinary concepts (ordinary income) in assessable income. Whether or not a particular amount is income according to ordinary concepts depends on the nature and character of the receipt in the hands of the taxpayer.

32. The Deposits constitute a term deposit product on which interest is payable. The Retirement Deposit Payments payable by Westpac comprise a component of interest (the Interest Payment), being the difference between the investor's Principal Amount and the sum of the Retirement Deposit Payments to be received by the investor (in the capacity of lender) in respect of their Deposit. The Interest Payments are compensation to the investor to be kept out of the use and enjoyment of the Principal Amount; are calculated by reference to the Principal Balance; and are paid periodically (refer *Federal Commissioner of Taxation v. Myer Emporium Ltd* [1987] HCA 18; (1987) 163 CLR 199; 87 ATC 4363; (1987) 18 ATR 693; *Federal Wharf Co. Ltd v. Deputy Federal Commissioner of Taxation* (1930) 44 CLR 24; and *Steele v. Federal Commissioner of Taxation* [1999] HCA 7; (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139).

33. Typically, the receipt of interest is ordinary income. Accordingly, the Interest Payments under a Deposit are ordinary income, assessable under section 6-5 in the income year in which they are paid or credited to the investor.

Deposits are not qualifying securities

34. Securities which are qualifying securities as defined in subsection 159GP(1) of the ITAA 1936 will be subject to the accruals provisions of Division 16E. A qualifying security must, among other requirements, have an eligible return. Subsection 159GP(3) defines an eligible return in relation to a security as follows:

> For the purposes of this Division, there shall be taken to be an eligible return in relation to a security if at the time when the security was issued it is reasonably likely, by reason that the security was issued at a discount, bears deferred interest or is capital indexed or for any other reason, having regard to the terms of the security, for the sum of all payments (other than periodic interest payments) under the security to exceed the issue price of the security, and the amount of the eligible return is the amount of the excess.

35. Thus, if the return (other than of the Principal Amount) to an investor in respect of their Deposit consists only of periodic interest payments, the Deposit will not have an eligible return and will not be a qualifying security for the purposes of Division 16E of the ITAA 1936.

36. The circumstances in which an amount of interest will be periodic interest are determined by the application of subsections 159GP(6) and 159GP(7) of the ITAA 1936. An amount of interest payable will not be periodic interest if the payment is not made in a manner which satisfies the provisions of subsection 159GP(6). Subsection 159GP(6) provides that:

> For the purposes of this Division, where an amount of interest is payable under a security, the amount shall be taken to be periodic interest if the period between the commencement of the period in respect of which the interest is expressed to be payable and the time at which the interest is payable is less than or equal to one year.

37. Therefore, if part of the Retirement Deposit Payments payable to an investor constitutes 'an amount of interest' that is paid at least annually, subsection 159GP(6) of the ITAA 1936 will take that interest payable to be periodic interest for the purposes of Division 16E, subject to the operation of subsection 159GP(7).

38. For the reasons set out in paragraph 32 of this Product Ruling, the Interest Payments (being the interest component of the Retirement Deposit Payments) constitute an amount of interest. The Interest Payments payable by Westpac under the Deposit on either a monthly, quarterly, semi-annual or annual basis is taken to be periodic interest under subsection 159GP(6). Subject to the operation of subsection 159GP(7) and excluding the Interest Payments, the sum of all the Retirement Deposit Payments to be received by an investor in respect of a Deposit could not exceed its issue price (the Principal Amount) and the Deposit therefore does not have an eligible return for the purposes of subsection 159GP(3).

39. A payment which satisfies the provisions of subsection 159GP(6) of the ITAA 1936 will nevertheless not constitute periodic interest if it is considered to be 'properly attributable' to a period in excess of one year. The effect of the application of subsection 159GP(7) of the ITAA 1936 to an interest payment that is expressed to be payable for a period less than or equal to one year, and would otherwise be periodic interest by the operation of subsection 159GP(6), is that if the Commissioner considers that the amount of the interest is properly attributable to a period in excess of one year, then the payment will not be regarded as periodic interest for the purposes of Division 16E.

40. The Commissioner will not exercise his discretion to determine, pursuant to subsection 159GP(7) of the ITAA 1936, that the Interest Payments will not be properly attributable to the period over which they are expressed to be payable and may not be considered to be periodic interest for the purposes of Division 16E. As such, none of the Interest Payments will form part of an eligible return in relation to a Deposit for the purposes of subsection 159GP(3) and the Deposits, both fixed payment and inflation adjusted, will not constitute qualifying securities as defined under subsection 159GP(1).

Deposits are traditional securities

41. A traditional security, in relation to a taxpayer, is defined in subsection 26BB(1) of the ITAA 1936. The Deposits satisfy the requirements of this definition as they, inter alia, are a security pursuant to paragraph 159GP(1)(b) of the ITAA 1936 and do not have an eligible return (as per paragraphs 34 to 40 of this Product Ruling).

42. Any gain made by the holder of a traditional security on the disposal or redemption of the traditional security is included in their assessable income of the year of income in which the disposal or redemption takes place (subsection 26BB(2) of the ITAA 1936). Alternatively, any loss made by the holder of a traditional security on disposal or redemption of the traditional security is allowable as a deduction from their assessable income of the year of income in which the disposal or redemption takes place (subsection 70B(2) of the ITAA 1936).

43. No gain or loss should arise for an investor upon the redemption of their Deposit on the Maturity Date for the purposes of subsection 26BB(2) or subsection 70B(2) of the ITAA 1936.

Division 230 – taxation of financial arrangements

44. Division 230 sets out the tax treatment of gains or losses from a 'financial arrangement'. Generally, a financial arrangement is a cash settlable legal or equitable right to receive a financial benefit, or obligation to provide such benefit, or a combination of one or more such right and/or obligations (subsection 230-45(1)). A right to receive or obligation to provide a financial benefit can be cash 'settlable' under subsection 230-45(2) if the benefit is money, or if it is a right the taxpayer intends to satisfy or settle by receiving money, or if it is an obligation that the taxpayer intends to satisfy or settle by providing money.

45. The Deposits constitute a financial arrangement for the purposes of Division 230 on the basis that investors have cash settlable rights to receive a financial benefit in the form of the Retirement Deposit Payments over the term of the Deposit, and a cash settlable obligation to provide a financial benefit in the form of the Principal Amount to Westpac.

46. However, where an arrangement is not a qualifying security for the purposes of Division 16E of the ITAA 1936 and an election under section 230-455 to have Division 230 of the ITAA 1997 apply to financial arrangements has not been made, then pursuant to section 230-455 of the ITAA 1997, Division 230 of the ITAA 1997 does not apply in relation to gains or losses from a financial arrangement held by:

(a) an individual; or

(b) a superannuation entity, a managed investment scheme or an entity substantially similar to a managed investment scheme under foreign law with assets of less than $100 million; or

(c) an ADI, a securitisation vehicle or other financial sector entity with an aggregated turnover of less than $20 million; or

(d) another entity with an aggregated turnover of less than $100 million, financial assets of less than $100 million and assets of less than $300 million.

Can Deposits be held by complying superannuation funds as segregated current pension assets?

47. A complying superannuation fund is entitled to an exemption for so much of its income as is attributable to its liability to pay current pensions. More specifically and pursuant to section 295-385, a complying superannuation fund is entitled to an exemption from income tax for so much of its ordinary income or statutory income (other than assessable contributions or non-arm's length income of the fund) to the extent that it is derived from the fund's segregated current pension assets, the meaning of which is set out in subsections 295-385(3), (4), (5) and (6).

48. Under this method of determining the exempt amount, the complying superannuation fund segregates its assets as specifically relating to its current pension liabilities to pay 'superannuation income stream benefits' as certified in an actuary's certificate or as prescribed by regulations. The prescribed superannuation income stream benefits include account-based pensions within the meaning of the *Superannuation Industry (Superannuation) Regulations 1994* (SISR) (regulation 295-385.01 of the ITAR 1997).

49. Subject to regulation 995-1.03 of the ITAR 1997, a superannuation income stream benefit is defined under regulation 995-1.01 of the ITAR 1997 to mean a payment from an interest that supports a 'superannuation income stream'. A superannuation income stream itself is defined under regulation 995-1.01 of the ITAR 1997 to include an income stream that is taken to be a pension for the purposes of the SISA in accordance with subregulation 1.06(1) of the SISR.

50. An account-based pension is a pension that meets the requirements in subregulation 1.06(1) of the SISR and in accordance with subregulation 1.03(1) of the SISR, is a pension that is provided in accordance with the rules of a fund that both meet the standards of subregulation 1.06(9A) of the SISR and are described in paragraph 1.06(9A)(a) of the SISR.

51. The Deposits are assets of a type to which, for the purposes of paragraph 1.06(9A)(a) of the SISR, an account balance may be attributed. Subject specifically to the assumptions set out in paragraphs 30(d) to (f) of this Product Ruling, the Deposits are therefore capable of being held by an investor who is a trustee of a complying superannuation fund as segregated current pension assets to support the payment of account-based pensions. Ultimately, whether any particular complying superannuation fund does hold the Deposits as part of its segregated current pension assets for the purposes of section 295-385 will depend on each fund's particular facts and circumstances.

Part IVA – anti-avoidance

52. 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

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/3

Subject references:

- exempt income
- income tax
- producing assessable income
- Product rulings
- Public rulings
- qualifying securities
- securities
- segregated current pension assets
- superannuation
- tax administration
- traditional securities

Legislative references:

- ITAA 1936
- ITAA 1936 26BB(1)
- ITAA 1936 26BB(2)
- ITAA 1936 70B(2)
- ITAA 1936 Div 16E
- ITAA 1936 159GP(1)
- ITAA 1936 159GP(3)
- ITAA 1936 159GP(6)
- ITAA 1936 159GP(7)
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 Div 230
- ITAA 1997 230-45(1)
- ITAA 1997 230-45(2)
- ITAA 1997 230-455
- ITAA 1997 230-455(7)
- ITAA 1997 295-385
- ITAA 1997 295-385(3)
- ITAA 1997 295-385(4)
- ITAA 1997 295-385(5)
- ITAA 1997 295-385(6)
- ITAR 1997
- ITAR 1997 295-385.01
- ITAR 1997 995-1.01
- ITAR 1997 995-1.03
- SISA 1993
- SISR 1994
- SISR 1994 1.03(1)
- SISR 1994 1.06(1)
- SISR 1994 1.06(9A)
- SISR 1994 1.06(9A)(a)
- TAA 1953
- Life Insurance Act 1995

Case references:

- Federal Commissioner of Taxation v. Myer Emporium Ltd [1987] HCA 18; (1987) 163 CLR 199; 87 ATC 4363; (1987) 18 ATR 693
- Federal Wharf Co. Ltd v. Deputy Federal Commissioner of Taxation (1930) 44 CLR 24
- Steele v. Deputy Commissioner of Taxation [1999] HCA 7; (1999) 197 CLR 459; 99 ATC 4242; (1999) 41 ATR 139

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