PR 2014/17 - Income tax: tax consequences of investing in CDIs over interests in the SPDR S&P 500 ETF Trust

This document has changed over time. This is a consolidated version of the ruling which was published on *17 September 2014*

Product Ruling

Income tax: tax consequences of investing in CDIs over interests in the SPDR® S&P 500® ETF Trust

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.

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 CHESS depository interests (CDIs) over units (Interests) in the SPDR® S&P 500® ETF Trust (the Fund) offered under a Product Disclosure Statement issued by State Street Bank and Trust Company as the trustee of the Fund (the Trustee) and State Street Global Advisors, Australia Services Limited (the AQUA Product Issuer).

3. This Product Ruling does not address:

(a) the taxation consequences of any financial accommodation the investor obtains to fund the purchase of their CDIs

(b) the taxation consequences of any costs (including brokerage charges) paid by the investor in relation to their CDIs

(c) the taxation consequences arising upon a transfer or assignment of the investor's CDIs to another party;

(d) the taxation consequences of any foreign exchange currency gains or losses arising under the scheme, and

(e) whether this 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 investor.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that are Australian residents for taxation purposes and who enter into the scheme described in paragraphs 16 to 20 of this Product Ruling on or after the date this Product Ruling is made, being 17 September 2014, and on or before 30 June 2017.

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

- enter into the scheme described in paragraphs 16 to 20 of this Product Ruling before this Ruling is published or after 30 June 2017
- participate in the scheme through offers made other than through the PDS, or who enter into an undisclosed arrangement with the promoter or a promoter associate, or an independent adviser that is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits) in any way
- trade in CDIs and are treated for taxation purposes as trading in the CDIs and/or other equity interests, carrying on a business of investing in CDIs and/or other equity interests, or holding the CDIs as trading stock or as a revenue asset, 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 20 of this Product 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.

Date of effect

10. This Product Ruling applies prospectively from 17 September 2014, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 17 September 2014 to 30 June 2017, 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 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 and the assumptions in paragraph 20 of this Product Ruling:

(a) Distributions from the Fund will be treated as dividends and will be assessable to the investor as the holder of the CDIs under section 97 of the *Income Tax Assessment Act 1936* (ITAA 1936).

(b) CDIs held by the investor are CGT assets under subsection 108-5(1).

(c) Any disposal of the CDIs by the investor on the AQUA market of the Australian Securities Exchange (ASX) will give rise to a CGT event A1 under section 104-10.

(d) Any capital gain realised by the investor from the disposal of the CDIs will be treated as a discount capital gain pursuant to section 115-5 where the investor is an individual, a complying superannuation entity, or a trust and has held the CDIs for at least 12 months.

(e) Subject to the foreign income tax offset limit in section 770-75, the investor will be entitled to a foreign income tax offset under Division 770 in an income year for foreign income tax paid by the investor (or CHESS nominee) on an amount received by the investor from the Fund that is included, in part or whole, in the investor's assessable income for that income year.

(f) CDIs held by the investor are not 'qualifying securities' as defined in subsection 159GP(1) of the ITAA 1936.

(g) Division 230 will not apply to any gains or losses with respect to this scheme where the investor is excepted from the Division pursuant to section 230-455.

(h) 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 the 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 1 May 2014 and 11 August 2014
- amended and restated standard terms and conditions of the Standard & Poor's Depository Receipts® (SPDR®) Trust Series 1, dated 1 January 2004
- US Prospectus of the SPDR® S&P 500® ETF Trust , dated 22 January 2014, and
- draft SPDR® S&P 500® ETF Trust Product Disclosure Statement (PDS) received on 11 August 2014.

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 the investor, or an associate of the investor, will be a party to, which are a part of the scheme. Unless otherwise defined, capitalised terms in this Ruling take their meaning as per the PDS.

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

Overview

19. Following is a summary of the scheme:

(a) The Aqua Product Issuer and Trustee will receive offers for Interests in the Fund from investors through an Authorised Participant and a PDS issued by the Aqua Product Issuer and the Trustee.

(b) The Fund is:

(i) a US exchange traded fund (ETF) which invests in a portfolio of securities with the objective of tracking the S&P 500 Index

(ii) a unit investment trust created under the laws of the State of New York, United States (US)

(iii) principally listed and trades on NYSE Arca, Inc. (the US exchange)

(iv) registered as an investment company under the US *Investment Company Act 1940,* as amended, and

(v) treated as a corporation for US federal income tax purposes.

(c) The Trustee and the Aqua Product Issuer propose to cross list the Fund on the AQUA market of the ASX. The cross listing will be implemented by the creation of CDIs over units in the Fund which represent an undivided ownership interest in the portfolio of securities of the Fund. Such CDIs will be quoted for trading under the AQUA rules (set out in Schedule 10A to the ASX Operating Rules).

(d) Legal title in the cross-listed units in the Fund will be held by the nominee of the US securities depository for an Australian depository nominee (the CHESS nominee) or its custodian.

(e) The Fund issues and redeems units at the net asset value (NAV) per Interest once each US business day. Only certain institutional investors (typically market makers or other broker-dealers) that are registered authorised participants in the US (US Authorised Participants) are permitted to purchase or redeem units directly with the Fund, and they may do so only in large blocks of 50,000 units.

(f) The CDIs will be created by an approved Authorised Participant arranging for the relevant basket of Fund units to be transferred to the CHESS nominee (or its custodian).

(g) On receipt of the Fund units the CHESS nominee will issue corresponding CDIs to the relevant Authorised Participant.

(h) Australian retail investors will only be able to trade in CDIs on the secondary market (the AQUA market of the ASX). That is, there will be no primary issues or redemptions of CDIs over units in the Fund to or by Australian retail investors.

(i) CDIs will be redeemed by the CHESS nominee cancelling CDIs and transferring the corresponding Fund units to the relevant Authorised Participant (or their relevant DTC participant).

(j) A CDI will confer on its holder (the investor) a beneficial interest in a unit in the Fund, including the distributions on those units. Each CDI corresponds to a single Fund unit on a one for one basis.

(k) Investors will be entitled to receive an amount representing dividends accumulated under the Fund less fees, quarterly or monthly as determined by the Trustee and the Sponsor. Other income may be distributed annually as determined by the Trustee.

Assumptions

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

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

(b) individual investors are not under a legal disability

(c) the Fund will qualify for taxation as a regulated investment company for US federal income tax purposes each year and by distributing all of its income each year will not be liable to pay US federal income tax or excise tax on its distributed income

(d) the investor is not treated for taxation purposes as trading in the CDIs, carrying on a business of investing in the CDIs and other equity interests, or holding the CDIs as trading stock or as a revenue asset

(e) any distributions by the Fund flowing to the CHESS nominee will be paid out of the Fund's current or accumulated earnings and profits and will therefore be treated as a dividend for US federal income tax purposes

(f) the scheme will be executed in the manner described in the scheme documentation referred to in paragraph 16 of this Product Ruling and in the Scheme section of this Ruling, and

(g) all dealings between the investor, the Aqua Product Issuer, CHESS nominee (or its custodian), the Sponsor and the Trustee will be at arm's length.

Commissioner of Taxation
17 September 2014

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.

Assessability of distributions to investors

21. CDIs provide a beneficial interest to the investor in the units in the Fund. Each CDI gives rise to a separate trust estate. Distributions from the Fund will represent income of each trust estate represented by a CDI and will be assessable to the investor under section 97 of the ITAA 1936.

22. Distributions from the Fund will be treated as dividends as the Fund is treated as a company for US federal income tax purposes.

23. According to the double tax treaty between Australia and the US (US Convention[1]) an entity will satisfy the definition of a company if the entity is treated as a company or body corporate for tax purposes.

24. Further, Article 10(6) of the US Convention defines the term 'dividend' to mean 'income from shares, as well as other amounts which are subjected to the same treatment as income from shares by the law of the State [in this case the US] of which the company making the distribution is a resident for the purpose of its tax.'

25. Therefore, any distributions made by the Fund flowing to the CHESS nominee will be treated as distributions made by a company and will have the same character as dividends. Accordingly, distributions from the Fund will be treated as dividends which will comprise the net income of each trust estate relating to the CDIs and will be assessable to the investor as the holder of those CDIs under section 97 of the ITAA 1936.

Application of CGT provisions on disposal of CDIs

Section 108-5: CGT asset

26. Under subsection 108-5(1) a CGT asset is any kind of property or a legal or equitable right that is not property. A CDI is a CGT asset under subsection 108-5(1).

---

[1] *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* [1983] ATS 16.

CGT event A1

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

28. The investor's capital proceeds under section 116-20 will be the amount they receive from the disposal of the CDIs on the AQUA market.

29. The cost base or the reduced cost base of the investor's CDIs will be the acquisition cost of the CDIs plus any incidental costs incurred by the investor in acquiring the CDIs (sections 110-25 and 110-55). The cost base or the reduced cost base of the investor's CDIs will be reduced by the amount of any distribution to the extent it is not treated as a dividend for US federal income tax purposes. If those distributions exceed the investor's existing cost base in their CDIs, a capital gain equal to the excess will arise.

Section 115-5: discount capital gains

30. 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 investor as a result of the disposal of the CDIs will be treated as a discount capital gain where the investor has held those CDIs for at least 12 months (excluding the days of acquisition and disposal).

31. To be a discount capital gain the capital gain must be made by an investor that is either an individual, a complying superannuation entity, or a trust (section 115-10).

Division 770 – foreign income tax offset

32. Division 770 allows a non-refundable tax offset for an income year for foreign income tax paid where that amount of foreign income tax is paid in respect of an amount that is included in your assessable income for the year.

33. To the extent that the investor has paid, or is deemed to have paid, foreign income tax (such as withholding tax at source):

(a) the foreign taxes paid by the investor will be regarded as foreign income tax for the purposes of section 770-15

(b) where those foreign taxes are paid by the CHESS nominee (or a custodian of the CHESS nominee), the foreign income tax will be deemed, under section 770-130, to have been paid by the investor, and

(c) subject to the foreign income tax offset limit in section 770-75 the investor will be entitled to a non-refundable foreign income tax offset in an income year for the foreign income tax the investor paid, or is deemed to have paid, on amounts that are included in the investor's assessable income that year.

Subsection 159GP(1) – a CDI is not a 'qualifying security'

34. A qualifying security is defined in subsection 159GP(1) of Division 16E of the ITAA 1936. For the purposes of determining whether an arrangement is a qualifying security, that arrangement must be a security, also defined in subsection 159GP(1) to mean:

(a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;

(b) a deposit with a bank or other financial institution;

(c) a secured or unsecured loan; or

(d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

35. CDIs acquired by the investor do not fall within paragraphs (a), (b), (c) or (d) of the definition of security in subsection 159GP(1) of the ITAA 1936. Therefore, the CDIs are not qualifying securities under subsection 159GP(1) of the ITAA 1936.

Division 230 – Taxation of financial arrangements

36. Division 230 sets out the tax treatment of gains or losses from a 'financial arrangement'.

37. 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 that $100 million, financial assets of less than $100 million and assets of less than $300 million.

Part IVA – anti-avoidance

38. 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

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

References

Previous draft:

Not previously issued as a draft

Subject references:

- product rulings
- public rulings
- tax administration
- unit trusts

Legislative references:

- ITAA 1936 97
- ITAA 1936 Pt III Div 16E
- ITAA 1936 159GP(1)
- ITAA 1936 159GP(1)(a)
- ITAA 1936 159GP(1)(b)
- ITAA 1936 159GP(1)(c)
- ITAA 1936 159GP(1)(d)
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 108-5
- ITAA 1997 108-5(1)
- ITAA 1997 110-25
- ITAA 1997 110-55
- ITAA 1997 Div 115
- ITAA 1997 115-5
- ITAA 1997 115-10
- ITAA 1997 116-20
- ITAA 1997 Div 230
- ITAA 1997 230-455
- ITAA 1997 Div 770
- ITAA 1997 770-15
- ITAA 1997 770-75
- ITAA 1997 770-130
- TAA 1953
- SISA 1993

Other references:

- US Convention

ATO references

NO:	1-5G2UKQW
ISSN:	1441-1172
ATOlaw topic:	Income Tax ~~ Product financing~~ finance