


PR 2014/7 - Income tax: tax consequences for a borrower procuring a new investment loan as part of a mortgage reduction program managed by Allstate Home Loans

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Product Ruling

Income tax: tax consequences for a borrower procuring a new investment loan as part of a mortgage reduction program managed by Allstate Home Loans

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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

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 1936* (ITAA 1936) unless otherwise indicated.
2. In this Product Ruling the scheme involves the refinancing of a borrower's home loan and the procurement of an investment loan, each managed by Allstate Home Loans Pty Ltd (ASHL), and entry by the borrower into a monitored service designed to assist them to accelerate the repayment of their refinanced home loan.
3. This Product Ruling does not:
 - address the deductibility of interest incurred by the borrower under the investment loan pursuant to section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);¹
 - address the treatment of any costs, fees and expenses (including borrowing expenses) payable by the borrower under the scheme;
 - apply to the original or refinanced home loan of the borrower, or to any offset account linked to the borrower's refinanced home loan;
 - address the borrower's tax obligations and benefits in relation to the acquisition/building, holding and sale of a residential property; and
 - address whether the scheme constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 (Taxation of financial arrangements).

¹ For the purposes of this Product Ruling, it is assumed at paragraph 20(b) that interest incurred by the borrower under the investment loan is deductible under section 8-1 of the ITAA 1997.

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 borrower.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that enter into the scheme described in paragraphs 16 to 20 of this Product Ruling on or after the date this Ruling is made 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 enter into this scheme before the date of this Ruling or after 30 June 2016.

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 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 9 April 2014, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 9 April 2014 until 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 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. The application of Part IVA of the ITAA 1936 depends on a careful weighing of all the relevant facts and circumstances of each case. Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA of the ITAA 1936 will not apply to deny the borrower of a deduction allowed under section 8-1 of the ITAA 1997 for interest incurred under an investment loan procured as part of the scheme.

Scheme

16. The scheme that is the subject of this Ruling is identified and described in the application for a Product Ruling as constituted by documents and information received on 26 February 2014 and 7 March 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 borrower, or any associate of the borrower, will be a party to, which are a part of the scheme.

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

19. Following is a summary of the scheme:

- (a) As part of its business as a mortgage manager, ASHL offers borrowers with a home loan in respect of a residential property that is their main residence the opportunity to participate in a scheme involving:
 - the refinancing of that home loan, the primary purpose of which is to repay it at an accelerated rate; and
 - the procurement of an investment loan used to fund either the acquisition or building of a residential investment property by the borrower for the purposes of producing assessable income.
- (b) The residential investment property acquired or built with the investment loan is a residential property other than the borrower's main residence that will not be used for business purposes. The borrower holds legal title to that property, as well as their main residence.
- (c) The application to refinance the home loan and procure the investment loan is completed and lodged by the borrower (via an accredited finance broker) with ASHL.
- (d) ASHL assesses the loan application in accordance with standard lending criteria which may, where necessary, include the undertaking of a valuation of the security by a licensed valuer, before sending the application off to a wholesale lender (referred to as a Funder for the purposes of this Product Ruling) with whom ASHL is a mortgage originator partner for their assessment and approval.
- (e) Whilst ASHL is responsible for the ongoing management of both the refinanced home loan and the investment loan, the credit to fund the borrower's loans will be made available by one or two Funders. The loans may or may not be funded by the same Funder. Upon approval of the borrower's application by the Funder(s), and the subsequent execution and return of new loan contracts by the borrower, the existing home loan will be settled and replaced by a new home loan funded by a Funder, and the new investment loan will be drawn and funded by the same, or another, Funder.
- (f) Some of the key features of the refinanced home loan are:
 - a maximum term of 30 years;

- a minimum loan amount of \$150,000 and a maximum loan limit of \$1,000,000;
 - periodic instalments by direct debit of either interest only or principal and interest;
 - interest accruing daily at either a variable rate (generally a discount variable rate) or a fixed rate, within accepted industry margins;
 - the provision of the loan on a full recourse basis; and
 - the holding of a registered mortgage by the Funder over the property financed, securing all amounts payable by the borrower under the refinanced home loan.
- (g) The refinanced home loan will either be in the form of a regular term loan or a line of credit. Where it takes the form of a term loan it will be linked to a 100% offset account into which all of the borrower's income (including that derived from the residential investment property funded by the investment loan) shall be deposited for the purposes of reducing the interest payable by the borrower on the refinanced home loan.² Repayments of principal and/or payments of interest in respect of both the refinanced home loan and the investment loan, as well as the monthly credit card balance owing in relation to a credit card used to pay all of the borrower's living expenses, shall be deducted automatically from the offset account.
- (h) Some of the key features of the investment loan are:
- a maximum term of 30 years;
 - a minimum loan amount of \$50,000 and a maximum loan limit of \$1,000,000;
 - periodic instalments by direct debit of interest only for 10 years, before converting to principal and interest thereafter. The borrower will always have periodic instalment obligations and will not capitalise and compound the interest on the loan;
 - interest accruing daily at either a variable rate (generally a standard variable rate) or a fixed rate, within accepted industry margins;
 - the provision of the loan on a full recourse basis; and

² See Taxation Ruling TR 93/6 'Income tax and fringe benefits tax: loan account offset arrangements' which is concerned with those arrangements, commonly referred to as interest offset arrangements, that are used to reduce the interest payable on a loan account.

- the holding of a registered mortgage by the Funder over the property financed, securing all amounts payable by the borrower under the investment loan.
- (i) The investment loan will not be a line of credit.
- (j) Neither of the refinanced home loan or the investment loan:
- is part of a linked or split loan facility as described in paragraphs 3 to 6 of Taxation Ruling TR 98/22;³
 - involve any capitalisation of interest;
 - are subject to any cross collateralisation; or
 - is part of an 'investment loan interest payment arrangement' as described in Taxation Determination TD 2012/1.⁴
- (k) At or around the same time as the refinanced home loan and the investment loan are drawn, the borrower begins to participate in a monitoring program set up by Go Figure Calculators Pty Ltd under which the borrower is provided with:
- software access to detail their income and expenditure budget for 12 months; and
 - initial assistance with the inputting of budget data and the evaluation and interpretation of their actual income and expenditure against that budgeted.

Assumptions

20. This Ruling is made on the basis of the following assumptions:
- (a) the borrower is an Australian resident for taxation purposes;
- (b) the investment loan relates to an asset held by the borrower for the purposes of gaining or producing assessable income, and the interest incurred by the borrower under that loan is deductible from their assessable income pursuant to section 8-1 of the ITAA 1997;

³ Income tax: the taxation consequences for taxpayers entering into certain linked or split loan facilities.

⁴ Income tax: can Part IVA of the *Income Tax Assessment Act 1936* apply to deny a deduction for some, or all, of the interest expense incurred in respect of an 'investment loan interest payment arrangement' of the type described in this Determination?

- (c) the borrower will not draw down on a line of credit to pay the interest on the investment loan, unless the borrower's refinanced home loan is a line of credit which is drawn down to make this payment,
- (d) all dealings between the borrower, ASHL, the Funders and Go Figure Calculators Pty Ltd will be at arm's length; and
- (e) the scheme will be executed in the manner described in the Scheme section of this Ruling.

Commissioner of Taxation

9 April 2014

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.*

Application of Part IVA

21. Part IVA is a general anti-avoidance rule which gives the Commissioner the power to cancel all or part of a tax benefit that has been obtained, or would, but for section 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies.

22. In broad terms, Part IVA will apply where the following requirements are satisfied:

- there is a 'scheme' as defined in section 177A;
- there is a 'tax benefit' that, in relation to allowable deductions, is defined in paragraph (b) of subsection 177C(1) as a deduction being allowable to the taxpayer in relation to a year of income where the whole or part of that deduction would not have been allowable, or might reasonably be expected not to have been allowable, to the taxpayer in relation to that year of income if the scheme had not been entered into or carried out;
- having regard to the eight objective matters identified in subsection (2) of section 177D, it would be concluded by a reasonable person that there was the necessary dominant purpose of enabling the taxpayer to obtain the tax benefit in connection with the scheme; and
- the Commissioner makes a determination that the whole or part of the amount of the tax benefit that is referable to the deduction shall not be allowable: paragraph 177F(1)(b).

Identification of the scheme

23. The term 'scheme' is defined very broadly in section 177A to mean:

- (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- (b) any scheme, plan, proposal, action, course of action or course of conduct.

24. The precise description of a scheme for the purposes of Part IVA will depend on the facts of the particular case. The circumstances described in paragraphs 16 to 20 of this Product Ruling constitute a scheme for the purposes of the definition set out in section 177A.

The tax benefit test

25. A tax benefit can arise to the borrower in relation to a year of income where the amount of deductible interest incurred on the investment loan is greater than the amount of interest that might reasonably be expected to have been allowable to the borrower under an investment loan but for entering into the scheme described in paragraphs 16 to 20 of this Product Ruling.

Dominant purpose

26. Arrangements that include all, or a significant number of the elements which constitute either a linked or split loan facility described in TR 98/22, or an investment loan interest payment arrangement described in TD 2012/1, can attract the application of Part IVA to deny any deduction otherwise allowable under section 8-1 of the ITAA 1997 for interest incurred under a loan used for business or income producing purposes.

27. Whilst the borrower may derive a tax benefit in connection with the scheme described in paragraphs 16 to 20 of this Product Ruling, it is not considered that obtaining the tax benefit is the dominant purpose of the borrower in entering into the scheme and Part IVA will not apply to deny the borrower of a deduction allowed for interest incurred under the investment loan. In this respect, the critical elements of the scheme described in this Product Ruling (and which distinguish the scheme from the type of arrangements which are subject to TR 98/22 or TD 2012/1) are set out in paragraphs 19(h), (i) and (j) of this Product Ruling.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 93/6, TR 98/22, TD 2012/1

Subject references:

- financial products
- interest
- product rulings
- public rulings
- taxation administration

Legislative references:

- ITAA 1936
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C(1)(b)
- ITAA 1936 177D(2)
- ITAA 1936 177F
- ITAA 1936 177F(1)(b)
- ITAA 1997 8-1
- ITAA 1997 Div 230
- SISA 1993
- TAA 1953

ATO references

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