



# ***PR 2017/2 - Income tax: deductibility of interest in relation to investment in units in the Macquarie Flexi 100 Trust issued on or before 30 June 2020***

 This cover sheet is provided for information only. It does not form part of *PR 2017/2 - Income tax: deductibility of interest in relation to investment in units in the Macquarie Flexi 100 Trust issued on or before 30 June 2020*

 This document has changed over time. This is a consolidated version of the ruling which was published on *24 January 2018*



## Product Ruling

### Income tax: deductibility of interest in relation to investment in units in the Macquarie Flexi 100 Trust issued on or before 30 June 2020

Contents	Para
<b>LEGALLY BINDING SECTION:</b>	
<b>What this Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>10</b>
<b>Ruling</b>	<b>15</b>
<b>Scheme</b>	<b>16</b>
<b>NOT LEGALLY BINDING SECTION:</b>	
<b>Appendix 1:</b>	
<b>Explanation</b>	<b>34</b>
<b>Appendix 2:</b>	
<b>Detailed contents list</b>	<b>83</b>

#### **📌 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

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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 part apply to the defined class of entities who participate in the scheme to which this Product 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 the Macquarie Flexi 100 Trust (the Fund) using a limited recourse loan (Investment Loan) made by Macquarie Specialist Investments Lending Limited (the Loan Provider) and the grant of put options (the Put Options) over the investment by the Loan Provider. It also covers any further loan that is used to fund the payment of interest on the Investment Loan (referred to as the Interest Loan). The Investment Loan and Interest Loan are in the form of the Loan and Put Option Agreement contained in section 3 of the Macquarie Flexi 100 Trust Information Booklet dated 27 March 2017 (Information Booklet) that forms part of the scheme.
3. This Product Ruling does not address:
  - the taxation consequences of the 'Walk-Away' feature (see subparagraph 19(u) of this Product Ruling), except for the taxation consequences to arise upon expiration of an Investor's Put Option (see subparagraph 15(l) of this Product Ruling)
  - the taxation consequences of the termination of the scheme as described in subparagraph 19(r) of this Product Ruling
  - the taxation consequences of an assignment of an Investor's Units in the Fund
  - the taxation consequences of fees paid by the Fund
  - the taxation consequences of fees paid to the Responsible Entity, 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:

- are subject to the taxation obligations, and
- can rely on the taxation benefits,

set out in the Ruling section of this Product Ruling.

5. The class of entities that can rely on the Ruling section of this Product Ruling consists of those entities that:

- enter into the scheme described in paragraphs 16 to 33 of this Product Ruling and execute relevant agreements mentioned in paragraph 16 of this Product Ruling on or after 27 March 2017 and on or before 30 June 2020
- at the time of entering into the scheme and on each interest payment date thereafter, have a purpose of staying in the scheme until it is completed (that is being a party to the relevant agreements until their term expires), and
- at the time of entering into the scheme, have a realistic expectation of deriving assessable income (other than capital gains) from the investment that exceeds the deductible expenditure incurred in connection with the investment.

These entities are referred to as Investor/s or, where the context specifically requires, Superannuation Investor/s.

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

- entities that, at the time of entering into the scheme and on each interest payment date thereafter, do not intend to hold their Units for the full term
- entities that, at the time of entering into the scheme, do not intend to derive assessable income (other than capital gains) from the investment that exceeds the deductible expenditure that they incur in order to invest in the scheme
- entities that are accepted to participate in the scheme described in paragraphs 16 to 33 of this Product Ruling and/or execute relevant agreements mentioned in paragraph 16 of this Product Ruling before 27 March 2017 or after 30 June 2020

- entities that participate in the scheme through offers made other than through the Macquarie Flexi 100 Trust Product Disclosure Statement (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
- entities that trade in units and/or other financial investments and are treated for taxation purposes as trading in the Units, carrying on a business of investing in the Units, or holding the Units as trading stock or as revenue assets
- trustees of Self Managed Superannuation Funds (Superannuation Investors) where the fund is not a regulated superannuation fund (as per section 19 of the *Superannuation Industry (Supervision) Act 1993* (SISA)), 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 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 33 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

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10. This Product Ruling applies prospectively from 27 March 2017. It therefore applies to the specified class of entities that enter into the scheme from 27 March 2017 to 30 June 2020, 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 the 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

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15. Subject to paragraph 3 of this Product Ruling and the assumptions in paragraph 33 of this Product Ruling:

- (a) Income distributions by the Fund are included in the assessable income of an Investor, in accordance with Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).
- (b) An amount equal to the interest charged on the Investment Loan, reduced by an amount reasonably attributable to the cost of capital protection calculated under the method statement in subsection 247-20(3), will be deductible under section 8-1.

- (c) Under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection under Division 247 in an income year is the amount by which the expense incurred for interest on the Investment Loan exceeds the amount of the loan multiplied by the adjusted loan rate (being the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans – Investor at the time when the interest charge is first incurred during the term of the loan, or the relevant part of the term, plus 100 basis points) (subsections 247-20(4) and 247-20(5)).
- (d) The amount reasonably attributable to the cost of capital protection under Division 247, as worked out under subparagraph 15(c) of this Product Ruling, is treated as the cost of acquiring Put Options granted by the Loan Provider to the Investor under subsection 247-20(6). This amount is not deductible under section 8-1.
- (e) Where an Investor enters into an Investment Loan and a full recourse Interest Loan, Division 247 will not apply to the Interest Loan.
- (f) An amount equal to the expense incurred for interest on the Interest Loan will be deductible under section 8-1.
- (g) Section 51AAA of the ITAA 1936 will not apply to deny an Investor a deduction for the interest expense allowable under section 8-1 of the ITAA 1997.
- (h) Section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest expense allowable under section 8-1 of the ITAA 1997.
- (i) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for the prepaid interest allowable under section 8-1 of the ITAA 1997 in respect of borrowings under an Investment Loan.
- (j) Section 82KZM of the ITAA 1936 will not apply to deny an Investor immediate deductibility of the prepaid interest on an Investment Loan allowable under section 8-1 of the ITAA 1997 where at least one of the following applies for the year of income:
- the Investor is a small business entity (as defined in subsection 328-110(1) of the ITAA 1997) that has not chosen to apply section 82KZMD of the ITAA 1936, or
  - the Investor is an individual who does not incur that expenditure in carrying on a business.

- (k) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for prepaid interest on borrowings under an Investment Loan that is allowable under section 8-1 of the ITAA 1997 to an Investor (other than a small business entity for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure) that is a taxpayer that is not an individual and does not carry on a business.
- (l) If an Investor does not exercise a Put Option on the relevant Put Option Exercise Date, the Put Option will expire (subsection 247-30(2)). CGT event C2 will happen under section 104-25 if a Put Option is not exercised on the relevant Put Option Exercise Date and expires. An Investor will make a capital loss that is equal to the reduced cost base of that Put Option under subsection 104-25(3).
- (m) The commercial debt forgiveness rules in Division 245 will not reduce the tax attributes of an Investor as a result of the debt forgiveness that occurs when the limited recourse provisions of the Investment Loan come into effect if they redeem their Units in the Fund, and the redemption proceeds will not fully repay the balance of the loan.
- (n) A Unit in the Fund is not a 'security' as defined in subsection 159GP(1) of the ITAA 1936.
- (o) Investors are deemed under subsection 272-5(3) of Schedule 2F to the ITAA 1936 to have fixed entitlements to all of the income and capital of the Fund.
- (p) The Loan Establishment Fee paid, if applicable, is deductible under section 25-25.
- (q) For the purposes of the ITAA 1936 and the ITAA 1997 (other than the purposes set out in subsection 235-815(2)) and pursuant to the operation of section 235-820, Units held on trust for a Superannuation Investor by Bond Street Custodians Limited (the Security Trustee) in the circumstances discussed at paragraph 20 to 23 of this Product Ruling will be treated as being the Superannuation Investor's asset (instead of an asset of the trust), and any act done in relation to the Units by the Security Trustee will be treated as if the act has been done by the Superannuation Investor (instead of the trustee).



- (r) The anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny the deductibility of the interest incurred by the Investor in respect of borrowings under an Investment Loan or an Interest Loan.

## Scheme

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

- application for a Product Ruling as constituted by documents and correspondence received on 22 February 2017, 8 March 2017, 25 March 2017, 27 March 2017 and 28 March 2017
- Product Disclosure Statement (PDS) and Information Booklet dated 27 March 2017 for the Macquarie Flexi 100 Trust prepared by Macquarie Financial Products Management Limited as responsible entity (Responsible Entity)
- Loan and Put Option Agreement contained in the Information Booklet
- draft Macquarie Flexi 100 Loan Trust Deed (Security Trust Deed) between the Loan Provider and the Security Trustee received on 25 March 2017, or (as applicable) any subsequent Security Trust Deed drafted on the same terms and conditions but for the definition of the term 'Flexi 100 PDS', and
- Constitution for the Macquarie Flexi 100 Trust (the Constitution) dated 21 February 2008 and Amending Deeds dated 21 April 2009, 6 May 2009 and 6 September 2011.

**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 Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor or any associate of an Investor, will be a party to, which are a part of the scheme. Unless otherwise defined, capitalised terms in this Product Ruling take their meaning as per the PDS, Information Booklet and Constitution referred to in paragraph 16 of this Product Ruling.

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:

*The Macquarie Flexi 100 Trust*

- (a) An investment in the Fund involves the subscription for ordinary fully paid Units in the Fund, an Australian unit trust registered as a managed investment scheme. The minimum amount required to be invested in the Fund by each Investor will be \$25,000 (or less subject to the discretion of the Responsible Entity).
- (b) The Fund is an open ended trust with a termination date no later than 80 years from its commencement.
- (c) The key terms of each Offer will be set out in the relevant Term Sheet, containing information such as the Offer open and Offer Close dates, Issue Dates and Maturity Dates. Each Term Sheet forms part of the PDS and can be obtained from the Fund's website at [www.macquarie.com.au/flexi](http://www.macquarie.com.au/flexi) and/or by contacting the Responsible Entity on 1800 080 033. **This Product Ruling applies to Investors who apply for Units under the PDS and whose Units are issued on the Issue Date being on or after 27 March 2017 and on or before 30 June 2020.**
- (d) Units in the Fund will be divided into Classes with the issue price of \$1 per Unit. The PDS describes the attributes and conditions that are attached to each Unit Class. These include the reference asset exposure attributed to a Unit (Reference Assets) and the corresponding investment return in the form of a Distribution.
- (e) The Reference Assets attributable to any one Class of Units to be offered in the Fund are specified in the PDS. The References Assets may include the following:

Reference Asset	Description
Asian Equity Basket	Weighted basket of stock market indices or index tracking funds, including some or all of the Hang Seng H-Share Index ETF, Tracker Fund of Hong Kong, MSCI Taiwan Index, KOSPI 200 Index and MSCI Singapore Index
Australian Equity	S&P/ASX 200 Index
Australian Equity Focus Basket	A weighted basket of at least two ASX-listed shares with large market capitalisation

Best-of Basket	The best performing of two baskets: the ASX Tilt Basket and the Bond Fund Tilt Basket
Bond Fund Tilt Basket	A fixed basket providing exposure to the PIMCO GIS Total Return Bond Fund (60%), S&P/ASX 200 Index (20%) and Winton Global Alpha Fund (20%)
Bond Fund Tilt (US) Basket	A fixed basket providing exposure to the PIMCO GIS Total Return Bond Fund (60%), S&P 500 Index (20%) and Winton Global Alpha Fund (20%)
Eurozone Equity	EURO STOXX 50® Index
Eurozone Select Dividend	EURO STOXX® Select Dividend 30 Index
International Basket	A basket comprising the S&P 500 Index, the EURO STOXX 50® Index, the Nikkei 225 Stock Average and the iShares Asia 50 ETF
International Low Volatility Basket	US and Eurozone-focused indices over equities with relatively low one year realised volatility, and a basket of indices and ETFs with exposure to equities in Hong Kong, Singapore, South Korea and Taiwan
US Equity	S&P 500 Index
US Equity Focus Basket	A basket comprising at least two shares listed on US exchanges with large market capitalisation
US Low Volatility	S&P 500 Low Volatility Index

- (f) Some Classes may pay fixed Distributions. The Term of each Offer varies and may be between 6 months and 8 years.
- (g) The Fund will have portfolios of assets and liabilities that will be referable to a particular Unit Class (Class Portfolio). Each of these Class Portfolios will be provided exposure to a Reference Asset through the Swap Agreement and Collateral Agreement to be entered by the Fund and the Swap Counterparty and Collateral Counterparty, respectively.
- (h) Under each relevant Swap Agreement, the Swap Counterparty will be required to pay the trustee of the Fund during the Term (the period from the Issue Date to Maturity) an amount reflecting the Distributions specified in subparagraph 19(l) of this Product Ruling.

- (i) Under the Collateral Agreement the Fund is required to place the Cash Collateral with the Collateral Counterparty.
- (j) The Cash Collateral is equal to the subscription amount for Units issued and is deposited with the Collateral Counterparty as collateral for the Fund's obligations under the Swap Agreement.
- (k) Some or all of the interest earned from the Cash Collateral will be applied to make payments to the Swap Counterparty under the Swap Agreement during the Term.
- (l) In return for the interest paid to the Swap Counterparty, the Swap Counterparty may pay to the Fund a fixed annual amount, payable at the end of each year throughout the Term, and potentially a fixed amount payable at Maturity. An additional variable amount (the Reference Asset Gain) may be paid at Maturity depending on the performance of the Reference Asset over the Term.
- (m) As each Class Portfolio will be covered by the agreements listed in paragraph 16 of this Product Ruling, the Investors may therefore be entitled to a fixed annual Distribution throughout the Term and potentially a fixed Distribution at Maturity as well as a Distribution relating to the Reference Asset Gain (if any).
- (n) The Constitution sets out the provisions relating to the calculation of the net income of the Fund and the Distribution of distributable income from the Fund. **This Product Ruling only applies where an Investor is entitled to benefit from Distributions as set out in the Constitution.**
- (o) Certain Units will have caps placed on the amount that will be paid to Investors. The cap will limit the amount of Reference Asset Gain that could be paid to an Investor at Maturity.
- (p) Hurdles may be used to determine whether a Reference Asset Gain will be paid at Maturity. If the Final Investment Level of a Reference Asset is greater than the Hurdle, then the Reference Asset Gain will be paid. However, the actual amount that will be paid to an Investor may be subject to the Term or Share Performance Cap.

- (q) The rate of the indicative and minimum Performance Caps will be set out in the relevant Term Sheet. Actual Performance Caps for each Class will be set on or before the Swap Start Date which is on or after the relevant Issue Date for that Class. The potential returns from an investment will be greater than the interest rate charged on the credit facilities described in subparagraphs 19(s) and (t) of this Product Ruling.
- (r) If the actual Performance Cap of a Unit is less than the minimum Performance Cap outlined on the Fund's website, then an Investor's participation into the scheme in respect of that Unit will be terminated. The consequences of this termination include the termination of the Loan and Put Option Agreement and the refund of the prepaid interest and, for the first Distribution Period, the refund of the Loan Establishment Fee (if any).

#### *Credit facilities*

- (s) There is a credit facility available to finance an investment in the Fund. This is an Investment Loan that Investors must enter into to finance the initial subscription for their Units in the Fund. This compulsory Investment Loan is limited recourse. The interest rate is fixed for 12 months on or around the anniversary of each Issue Date.
- (t) The second credit facility available is an optional full recourse Interest Loan which allows the Investor to fund the interest payment on the Investment Loan. An Interest Loan is not available to Superannuation Investors.

#### *'Walk-Away' feature*

- (u) Investors can exercise the 'Walk-Away' feature described in the PDS and the Loan and Put Option Agreement. This feature involves the ability of Investors to exercise the Put Options as described in paragraph 32 of this Product Ruling before the Maturity Date.

### **Security Trust Deed (Superannuation Investors)**

20. When a Superannuation Investor (being a trustee of a Self Managed Superannuation Fund) subscribes for Units in the Fund, the Units will be issued to, and held by, the Security Trustee on a separate trust solely for the Superannuation Investor in accordance with the terms of the Security Trust Deed by which the Superannuation Investor is bound.

21. Under the Security Trust Deed, the Superannuation Investor is entitled to benefit from Distributions as set out in the Constitution.

22. The Security Trust Deed also provides security (a Mortgage) for the Investment Loan in favour of the Loan Provider. Pursuant to the Security Trust Deed, the Security Trustee assigns the Units and related rights it holds for each Superannuation Investor (the Mortgaged Property) to the Loan Provider to secure the Superannuation Investor's obligations under the Investment Loan.

### **Loan and Put Option Agreement**

23. The Loan and Put Option Agreement will be between the Loan Provider and an Investor who takes out an Investment Loan to finance their investment in the Fund. This agreement also sets out the terms of the optional full recourse Interest Loan.

24. The Investment Loan will be limited recourse for the Loan Provider in respect of the principal owing on an Investment Loan. Accordingly, any amount payable by an Investor to the Loan Provider is limited to the Investor's Units and their proceeds.

25. The Loan and Put Option Agreement provides that Investors may redeem their Units in the Fund on the Maturity Date and they may also be given the opportunity to retain their Units. If Investors are given the option to retain their Units in the Fund, they will still be required to repay their Investment Loan and any Interest Loan at Maturity. **This Product Ruling does not apply to schemes entered into after the Maturity Date, including the retention of Units by Investors.**

26. The terms of the agreement in respect of the Investment Loan are:

- interest is payable annually in advance for the term of the loan. The first interest payment date will be on the Issue Date, and each subsequent interest payment date will be on or around the anniversary of each Issue Date (each, an Investment Loan Interest Payment Date)
- the Interest Rate is fixed for the prepaid interest period (which will be twelve months or less). The indicative interest rate for the first interest period will be available on the relevant Term Sheet. The actual Interest Rates will be determined by the Loan Provider on or around one week prior to the relevant Issue Date and, if different to the indicative interest rate, published on the Fund website, and
- the agreement will end at the Maturity Date for each Class of Units.

27. The agreement also sets out the terms of the full recourse Interest Loan that is available to an Investor (who is not a Superannuation Investor) to fund the interest payment on the Investment Loan due on the Issue Date and subsequent Investment Loan Interest Payment Dates. The Interest Loan is repayable by monthly in arrears principal and interest payments over the prepaid interest period on the Investment Loan and is limited to a period of twelve months; the interest is fixed for this period. The term of the Interest Loan cannot be extended and the indicative interest rate for an Interest Loan for the first interest period will be available in the relevant Term Sheet.

28. The obligations of an Investor (who is not a Superannuation Investor) under the Loan and Put Option Agreement will be secured by a Mortgage to be granted by the Investor in respect of the Units held and all related rights as holder of those Units (including proceeds) and also by the Collateral Security to be granted by the Responsible Entity over the Investor's interest in the Cash Collateral.

29. The obligations of an Investor (who is a Superannuation Investor) under the Loan and Put Option Agreement will be secured by a Mortgage to be granted by the Security Trustee (as per paragraph 22 of this Product Ruling) and also by the Collateral Security to be granted by the Responsible Entity over the Superannuation Investor's interest in the Cash Collateral.

30. A Loan Establishment Fee of up to 2% of the Investment Loan may be charged by the Loan Provider. This fee is payable in full on the Issue Date if an Interest Loan is not utilised.

31. Where Investors take out an Interest Loan, they will be advanced the amount of the Loan Establishment Fee (if applicable) as part of the first Interest Loan and that Loan Establishment Fee is payable by monthly repayments over the first year of the investment. These additional payments will be direct debited from an Investor's nominated bank account.

## **Put Option**

32. The Loan and Put Option Agreement also sets out the terms of the grant of Put Options by the Loan Provider. As consideration for this grant, an Investor promises to pay the Put Option Premium. If not exercised in accordance with this agreement, each Put Option automatically lapses on the relevant Put Option Exercise Date.

## **Assumptions**

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

- (a) the Investor is an Australian resident for taxation purposes

- (b) the Superannuation Investor is a trustee of a regulated superannuation fund (as per section 19 of the SISA)
- (c) the dominant purpose of the Investor in entering into and carrying out the scheme is to derive an amount of assessable income (other than capital gains) from the investment that exceeds the total expenses that an Investor incurs in connection with this investment
- (d) the Investor is not a trader in investments and is not treated for taxation purposes as trading in Units in the Fund, carrying on a business of investing in the Fund, or holding their Units in the Fund as trading stock or as a revenue asset
- (e) in respect of any interest amounts paid in advance under the Investment Loan, these may be prepaid, but only in relation to a payment period of 12 months or less that ends on or before the last day of the income year following the expenditure year
- (f) the scheme will be executed in the manner described in the scheme documentation listed in paragraph 16 of this Product Ruling and in the Scheme section of this Product Ruling
- (g) all dealings between the Investor and the Macquarie group of companies, including the Security Trustee, Responsible Entity and the Loan Provider, will be at arm's length
- (h) at the time of the prepayment the Fund will have at least 300 unit holders, thereby satisfying the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936
- (i) [omitted]
- (j) the Fund will not be an attribution managed investment trust pursuant to section 276-10
- (k) the Investment Loan made to the Superannuation Investor is covered by the exception in subsection 67A(1) of the SISA
- (l) the Superannuation Investor is not prevented from investing in the scheme by any particular terms of its trust deed, and is not in breach of any of its stated investment guidelines and strategies, and
- (m) the Investor will not enter into the scheme with the intention to terminate their participation in the scheme early.



Product Ruling

# PR 2017/2

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Page 16 of 28

Page status: **legally binding**

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5 April 2017

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## 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.*

### Section 8-1 and Division 247

34. Interest paid on a borrowing used to acquire income producing assets, such as units in a unit trust, is generally treated as deductible under section 8-1 where it is expected that assessable income would be derived from the investment (see Taxation Ruling TR 95/33 *Income tax: subsection 51(1) – relevance of subjective purpose, motive or intention in determining the deductibility of losses and outgoings*). Investors in the Fund expect to derive assessable income in the form of fixed distributions (for some Classes) and if available, a Reference Asset Gain. The assessable income from their investments is expected to be in excess of the expenditure Investors incur in connection with the investment. However, the ability to claim interest deductions may be subject to Division 247.

35. Section 247-10 describes when a borrowing under an arrangement satisfies the requirements as a capital protected borrowing. Subsection 247-10(1) states:

An arrangement under which a borrowing is made, or credit is provided, is a **capital protected borrowing** if the borrower is wholly or partly protected against a fall in the market value of a thing (the **protected thing**) to the extent that:

- (a) the borrower uses the amount borrowed or credit provided to acquire the protected thing; or
- (b) the borrower uses the protected thing as security for the borrowing or provision of credit.

36. Subsection 247-10(2) states:

That protection is called **capital protection**.

37. Where an Investor enters into an Investment Loan in order to acquire Units in the Fund, that Investor is wholly or partly protected against a fall in the market value of the acquired Units through the operation of Put Options that the Investor acquires under the Loan and Put Option Agreement.

38. However, under clause 2.1 of the Loan and Put Option Agreement, the Loan Provider will only provide a loan to an Investor where that Investor has paid all of the interest that is payable on the Investment Loan on the Investment Loan Drawdown Date, or where the Investor has applied for an Interest Loan and this has been accepted by the Loan Provider.

39. Where Units are redeemed by the Investor at Maturity, the limited recourse aspect of the Investment Loan means that the amount payable by the Investor to the Loan Provider is limited to the proceeds of the redeemed Units (section 5.1.1 of the PDS).

Clause 10 of the Loan and Put Option Agreement reinforces this limitation where it is stated:

... your [the Investor] liability to pay any amount in respect of the Investment Loan under this agreement may only be discharged from, and our [the Loan Provider] recourse against you [the Investor] in respect of any such amount is limited to, the amount which we [the Loan Provider] can obtain by enforcing our rights relating to the Mortgaged Property (and, if you are a Superannuation Trustee, under the Security Trust Deed) ...

40. Where an Investor takes out an Investment Loan, that Investor will be granted Put Options by the Loan Provider in consideration for the Investor's promise to pay the Put Option Premium pursuant to clause 1.4 of the Loan and Put Option Agreement. The cost of capital protection associated with acquiring the Put Options is not deductible for tax purposes.

41. Clause 5 of the Loan and Put Option Agreement states that each Put Option constitutes an irrevocable offer (by the Loan Provider to the Investor) to, on effective exercise of that Put Option, buy the Put Property for the Sale Price on the relevant Put Option Exercise Date (subject to certain conditions).

42. However, clause 5(c) of the Loan and Put Option Agreement states that the Loan Provider may set-off the Outstanding Money in relation to each Loan against the Sale Price of the Put Property payable by the Loan Provider to the Investor where an Investor exercises a Put Option on the Put Option Exercise Date. As such the Put Option arrangements provide some form of capital protection to Investors.

43. Under the arrangement where an Investor chooses to enter into a full recourse Interest Loan in addition to a limited recourse Investment Loan only the borrowing under the limited recourse Investment Loan is considered to be subject to capital protection.

44. An Interest Loan can only be taken out by an Investor on a full recourse basis. Section 5.2.1 of the PDS confirms the full recourse nature of this type of loan. There is no element of capital protection connected with this type of loan.

45. As the Interest Loan is issued on a full recourse basis, the Investor will need to use their own funds to cover any shortfall (including any break costs), that is associated with this loan.

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

47. Under the scheme, the amount reasonably attributable to the cost of capital protection afforded by the limited recourse provisions of the Investment Loan is worked out according to the method statement in subsection 247-20(3) as set out in subparagraph 15(c) of this Product Ruling. This amount is treated as the cost of the Investor's Put Option under subsection 247-20(6).

48. For an Investor in the scheme, the Put Option is a capital asset. As the cost of capital protection is the cost of the Investor's Put Option, this expense is capital in nature. The interest charged on the Investment Loan will be deductible under section 8-1 only to the extent that it does not constitute the cost of capital protection.

### **Section 51AAA**

49. Under the scheme, it is contemplated that over the period of an Investor's involvement there will be assessable income derived by way of distributions of the net income of the Fund. As interest will be deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of any net capital gain in the Investor's assessable income, section 51AAA of the ITAA 1936 has no application to an Investor.

### **Section 82KL**

50. The operation of section 82KL of the ITAA 1936 depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL of the ITAA 1936. It will not apply to deny the deductions otherwise allowable under section 8-1 of the ITAA 1997.

### **Subdivision H of Division 3 of Part III**

51. Subdivision H of Division 3 of Part III of the ITAA 1936 (Subdivision H) deals with the timing of deductions for certain advance expenditure incurred under an agreement in return for the doing of a thing under that agreement that will not be wholly done within the same year of income. Separate rules apply depending on whether the expenditure is incurred in carrying on a business, whether the Investor is a 'small business entity', whether the Investor is an individual and whether the Investor is not an individual and incurs the expenditure otherwise than in carrying on a business. This Subdivision does not apply to 'excluded expenditure', which is defined in subsection 82KZL(1) of the ITAA 1936 to include amounts of less than \$1,000 or amounts of expenditure that are of a capital nature.

## **Subdivision 328-C – small business entities for the purposes of Subdivision H**

52. Under section 328-110, an Investor carrying on a business in an income year will be a small business entity for that year (the current year) if:

- (a) the Investor carried on a business in the previous income year and the aggregated turnover for that year was less than \$2 million
- (b) the aggregated turnover for the current year is likely to be less than \$2 million and, where the Investor carried on a business in each of the two previous income years, the aggregated turnover for each of those income years was less than \$2 million, or
- (c) the aggregated turnover for the current year, worked out as at the end of the year, is less than \$2 million.

## **The eligible service period for the purposes of Subdivision H**

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

## **Sections 82KZME and 82KZMF – prepaid expenditure and tax shelter arrangements**

54. The rules in sections 82KZME and 82KZMF of the ITAA 1936 apply, subject to the exceptions in section 82KZME, where expenditure is incurred in relation to a 'tax shelter' arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

55. For the purposes of section 82KZME of the ITAA 1936, 'agreements' are broadly defined to include an entire arrangement of which a contract may form part. Under subsection 82KZME(4) of the ITAA 1936, the relevant 'agreement' includes all the contractual arrangements and activities associated with the participation in a Fund, including the financing and management arrangements.

56. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude the interest deductible under section 8-1 of the ITAA 1997 incurred on borrowings under the

Investment Loan, from the operation of section 82KZMF of the ITAA 1936 as:

- the prepaid interest deductible under section 8-1 of the ITAA 1997 is incurred in respect of money borrowed to acquire units in a widely held unit trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936
- the Investor can reasonably expect to obtain trust income from the investment
- the Investor will not obtain any other kind of assessable income from the investment, except for capital gains, and
- all aspects of the scheme will be conducted at arm's length.

57. Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 58 to 63 of this Product Ruling.

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

58. Section 82KZM of the ITAA 1936 operates to spread over more than one income year a deduction for prepaid expenditure incurred by a taxpayer that is either:

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

59. The expenditure must not be excluded expenditure and must be incurred otherwise than in carrying on a business. Section 82KZM of the ITAA 1936 applies if the eligible service period for the expenditure is longer than 12 months, or the eligible service period for the expenditure is 12 months or shorter but ends after the last day of the year of income after the one in which the expenditure was incurred and the expenditure would otherwise be immediately deductible under section 8-1 of the ITAA 1997.

60. As the eligible service period in relation to a deductible interest payment under an Investment Loan is no longer than 12 months and does not end after the last day of the year of income after the one in which the expenditure was incurred, section 82KZM of the ITAA 1936 will have no application to Investors who are small business entities for the year of income, or to Investors who are individuals and the expenditure is not incurred in carrying on a business. Investors who satisfy these tests will be able to claim an immediate deduction for the interest allowable under section 8-1 of the ITAA 1997 that is incurred under an Investment Loan.

### **Sections 82KZMA and 82KZMD – prepaid non-business expenditure incurred by non-individuals and non-small business entities**

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

62. The expenditure must not be excluded expenditure and must be incurred in return for the doing of a thing under an agreement that is not wholly done within the expenditure year.

63. For these Investors, the deduction for prepaid interest on the Investment Loan will be apportioned over the relevant interest payment period.

### **Division 110 – cost base of the Put Options**

64. As the Loan and Put Option Agreement specifies more than one occasion on which the capital protection can be invoked, the income tax legislation applies as if there were a separate Put Option for each of those occasions, being each Put Option Exercise Date (subsection 247-25(1)).

65. The proportion of the Put Option Premium that is reasonably attributable to each Put Option is taken to have been incurred for that Put Option (subsection 247-25(1)). The proportion of the Put Option Premium that is reasonably attributable to each Put Option is the Put Option Premium multiplied by the number of days from the previous Put Option Exercise Date (or, in relation to the first Put Option Exercise Date, from the Issue Date) to the Put Option Exercise Date applicable to that Put Option, and divided by 365. That proportion of the Put Option Premium will form part of the cost base (under subsection 110-25(2)) and the reduced cost base (under subsection 110-55(2)) of the Put Option.

66. If an Investor does not exercise a Put Option on the relevant Put Option Exercise Date, that Put Option will expire (subsection 247-30(2)). Where a Put Option expires, CGT event C2 will happen (paragraph 104-25(1)(c)). The capital proceeds on the expiry of the Put Option will be nil. Therefore, an Investor will make a capital loss from CGT event C2 that is equal to the reduced cost base of the Put Option.

### **Division 245 – commercial debt forgiveness**

67. The Investment Loan is a commercial debt under section 245-10.

68. Where the limited recourse provisions of the Investment Loan come into effect, an Investor is not required to repay the shortfall between the loan balance and the redemption proceeds of the Units. This will result in the forgiveness of a commercial debt at that time, under paragraph 245-35(a).

69. Under Division 245, where the forgiveness of a commercial debt results in the Investor having a positive 'net forgiven amount', the Investor will be required to reduce certain tax attributes that could otherwise reduce their taxable income (in the same or a later income year), to the extent of the net forgiven amount.

70. To calculate the net forgiven amount of a debt, it is first necessary to calculate the 'gross forgiven amount' of a debt. In the Investor's circumstances, Division 245 will have no practical effect as there will be no gross forgiven amount in respect of the Investment Loan. The gross forgiven amount is equal to the value of the debt when it is forgiven less the amount (if any) that is offset against the value of the debt when it is forgiven.

71. The value of the Investment Loan (being a debt owed by an Investor) when it is forgiven is worked out under subsection 245-60(1). Subsection 245-60(1) applies because, under subsection 245-60(2):

- (a) the Investor will have incurred the debt directly in respect of financing the acquisition of property by the Investor, and
- (b) the creditor's rights against the Investor in the event of default in the payment of the debt or interest will be, just before the debt is forgiven, limited to rights in respect of a mortgage or other security over the property.

72. Under subsection 245-60(1), the value of the Investment Loan when it is forgiven is the market value at that time of the creditor's rights mentioned in paragraph 245-60(2)(b) (being the redemption price of the Units at that time, which is based on the net asset value per Unit for the relevant Class of Units). This is because the creditor has no right to recover the shortfall between the loan balance and the redemption proceeds of the Units.



73. The Investment Loan is a 'money lending debt' (being a debt resulting from a loan of money in the ordinary course of a business of lending money carried on by the creditor, the Loan Provider) and neither of items 4 and 6 of the table in subsection 245-65(1) apply. Therefore, item 1 of the table in subsection 245-65(1) will apply.

74. The amount that is offset against the value of a debt when it is forgiven is the market value, at the time of the forgiveness, of each item of property (other than money) that the debtor (an Investor) has given as a result of, or in respect of, the forgiveness of the debt. The market value of this property (the Investor's interest in the Units in the Fund) will be the redemption price of the Units at the time of the forgiveness.

75. Therefore, as the value of the Investment Loan when it is forgiven will be equal to the amount that is offset against the value of the loan when it is forgiven, there will be no gross forgiven amount in respect of the loan (subsection 245-75(2)).

76. Accordingly, the commercial debt forgiveness rules in Division 245 will not reduce the tax attributes of an Investor as a result of the debt forgiveness that occurs when the limited recourse provisions of the Investment Loan come into effect.

### **Subsection 159GP(1) – a Unit in the Fund is not a 'security'**

77. Subsection 159GP(1) of the ITAA 1936 defines the term 'security'. Units in a unit trust will not be a security under paragraphs (a), (b) or (c) of the definition in subsection 159GP(1). Furthermore, units in a unit trust will not fall within the definition in paragraph (d) of subsection 159GP(1) unless there is a contract between the 'manager' of the unit trust (now commonly referred to as the responsible entity) and the unit holder under which there is a liability to pay an amount, and on the facts, that contract is found to be debt like (see paragraphs 4(ii) and 34 to 39 of Taxation Ruling TR 96/14 *Income tax: traditional securities*).

78. A Unit in the Fund is not considered to be a contract between the Responsible Entity and the Investor (as a Unit holder), nor are the obligations between the Responsible Entity and the Investor considered to be debt like. Therefore, a Unit in the Fund does not meet the definition of security under subsection 159GP(1) of the ITAA 1936.

### **Section 25-25 – Loan Establishment Fee**

79. The Loan Establishment Fee, if applicable, incurred by an Investor upon successful application for an Investment Loan will be an allowable deduction pursuant to section 25-25. The Loan Establishment Fee will be deductible on a straight line basis over the period of the shorter of:

- the term of the Investment Loan, or

- five years.

**Division 235 – look-through treatment for instalment trusts**

80. The object of Division 235 is to ensure that, for most income tax purposes, the consequences of ownership of a certain type of asset (referred to as an ‘instalment trust asset’) flow to the investor that has a beneficial interest in that asset as the beneficiary of an ‘instalment trust’, instead of to the trustee of the instalment trust. Essentially, this means treating the investor (and not the trust) as the owner of the asset and treating any act done by the trustee in relation to the asset as if the act had been done by the investor (instead of by the trustee): subsections 235-820(1) and 235-820(2).

81. Each Separate Trust created under the terms of the Security Trust Deed for the purposes of holding the Units of a Superannuation Investor on trust by the Security Trustee as trustee for the Superannuation Investor will be an instalment trust pursuant to paragraph 235-825(1)(b) on the basis that they will be covered by section 235-840 (about limited recourse borrowings by regulated superannuation funds).

**Part IVA**

82. Provided that the scheme ruled on is entered into and carried out in the manner described in the scheme documentation and in the Scheme section of this Product Ruling including the assumptions (see paragraphs 16 to 33 of this Product Ruling), it is accepted that the scheme is an ordinary commercial transaction and that Part IVA of the ITAA 1936 will not apply.

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

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

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Class of entities	4
<i>Superannuation Industry (Supervision) Act 1993</i>	7
Qualifications	8
<b>Date of effect</b>	<b>10</b>
Changes in the law	12
Note to promoters and advisers	14
<b>Ruling</b>	<b>15</b>
<b>Scheme</b>	<b>16</b>
Overview	19
Security Trust Deed (Superannuation Investors)	20
Loan and Put Option Agreement	23
Put Option	32
Assumptions	33
<b>Appendix 1 – Explanation</b>	<b>34</b>
Section 8-1 and Division 247	34
Section 51AAA	49
Section 82KL	50
Subdivision H of Division 3 of Part III	51
Subdivision 328-C – small business entities for the purposes of Subdivision H	52
The eligible service period for the purposes of Subdivision H	53
Sections 82KZME and 82KZMF – prepaid expenditure and tax shelter arrangements	54
Section 82KZM – prepaid expenditure incurred by small business entities and individuals incurring non-business expenditure	58
Sections 82KZMA and 82KZMD – prepaid non-business expenditure incurred by non-individuals and non-small business entities	61
Division 110 – cost base of the Put Options	64
Division 245 – commercial debt forgiveness	67
Subsection 159GP(1) – a Unit in the Fund is not a ‘security’	77
Section 25-25 – Loan Establishment Fee	79

Division 235 – look-through treatment for instalment trusts	80
Part IVA	82
<b>Appendix 2 – Detailed contents list</b>	<b>83</b>

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Not previously issued as a draft

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TR 95/33; TR 96/14

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