



# ***PR 2019/5 - Income tax: taxation consequences of investing in the Westpac Protected Equity Loan***

 This cover sheet is provided for information only. It does not form part of *PR 2019/5 - Income tax: taxation consequences of investing in the Westpac Protected Equity Loan*

 This document has changed over time. This is a consolidated version of the ruling which was published on 4 September 2019



## Product Ruling

### Income tax: taxation consequences of investing in the Westpac Protected Equity Loan

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#### **❗ Relying on this Ruling**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in the Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

## No guarantee of commercial success

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The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

## Terms of use of this Product Ruling

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

## What this Ruling is about

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1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section apply to the defined class of entities that takes part in the scheme to which this Product Ruling relates. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.

2. In this Product Ruling the scheme is referred to as the Westpac Protected Equity Loan (the PEL) offered by Westpac Banking Corporation (the Bank) and issued under the Westpac Protected Equity Loan Product Disclosure Statement dated 22 July 2013 (PDS), as supplemented by the Supplementary Product Disclosure Statement dated 30 May 2014, the Supplementary Product Disclosure Statement dated 1 December 2015, the Notice to investors dated 12 November 2016, the Notice to investors dated 30 October 2018 and the Notice to investors dated 1 July 2019.

3. This Product Ruling does not address:

(a) The taxation consequences of:

- a Loan advanced against an existing Parcel of Securities held by the investor
- a Trigger Event causing the Loan to terminate (in whole or in part) prior to the Maturity Date. This includes:
  - a voluntary early repayment of the whole or any part of the Loan
  - a Default event occurring
  - a Corporate Action occurring, and
  - the declaration of an Early Maturity Date by the Bank.
- using a Top-up Loan
- using the Portfolio Adjustment Facility
- using the Security Reset Facility
- a transfer of the investor's rights and obligations under the Loan (including the Put Option and the interest in the Parcel that corresponds to the Loan)
- an extension of the Term of the Loan or refinancing the Loan
- acquiring and disposing of a Parcel of Securities

- an exercise of the Put Option in conjunction with the disposal of the corresponding Parcel of Securities, and
  - paying any fees and costs under the PEL (other than interest, the Capital Protection Fee, Application Fee and Cash Settlement Amount).
- (b) An investor's entitlement to franking credits, except as provided for in paragraphs 15(k) and 47(b) of this Product Ruling.
- (c) 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 that can rely on the Ruling section of this Product Ruling consists of those entities that are accepted to participate in the scheme specified in this Ruling on or after 1 July 2019 and on or before 30 June 2022. They must have a purpose of remaining in the scheme until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income (other than capital gains) from the investment that exceeds the deductible expenditure incurred in connection with the investment.

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

- intend to terminate their investment in the scheme prior to its completion
- 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
- are accepted to participate in the scheme described in the Ruling before 1 July 2019 or after 30 June 2022<sup>1</sup>

<sup>1</sup> Entities that were accepted to participate in the PEL on or after 22 July 2013 and on or before 30 June 2016, and that satisfied all other requirements at paragraphs 5 and 6 of Product Ruling PR 2013/20 *Income tax: tax consequences of investing in the Westpac Protected Equity Loan*, can rely on the Ruling section of that Product Ruling. Entities that were accepted to participate in the PEL on or after 1 July 2016 and on or before 30 June 2019, and that satisfied all other requirements at paragraphs 5 and 6 of Product Ruling PR 2016/10 *Income tax: tax consequences of*

- 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 Securities and are treated for taxation purposes as trading in Securities, carrying on a business of investing in the Securities, or holding the Securities as trading stock or as revenue assets
- trade in the Put Option(s) and are treated for taxation purposes as trading in the Put Option(s), carrying on a business of investing in the Put Option(s), or holding the Put Option(s) 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 it 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.

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## Date of effect

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10. This Product Ruling applies from 1 July 2019. It therefore applies only to the specified class of entities that enter into the scheme from 1 July 2019 until 30 June 2022, 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.

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## Ruling

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15. Subject to paragraph 3 of this Product Ruling and the assumptions in paragraph 20 of this Product Ruling:

- (a) Where the cost of the Put Option (the Capital Protection Fee) is paid as a component of the interest rate charged on the Loan:
  - (i) the interest incurred under the Loan, reduced by an amount reasonably attributable to the cost of capital protection worked out under step 3 of the method statement in subsection 247-20(3), will be deductible under section 8-1 to the extent that it does not correspond to the part of the Loan that is used to fund Brokerage

- (ii) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the interest incurred under the Loan for the income year exceeds the amount of the Loan multiplied by the sum of the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans – Investor and 100 basis points (the 'adjusted loan rate') at the time when the interest charge is first incurred during the term of the Loan, or the relevant part of the term (subsections 247-20(4) and 247-20(5)), and
  - (iii) the amount reasonably attributable to the cost of capital protection as worked out under paragraph 15(a)(ii) of this Product Ruling, is treated as the cost of the Put Option under subsection 247-20(6). This amount is not deductible under section 8-1.
- (b) Where the cost of the Put Option (the Capital Protection Fee) is paid as an upfront lump sum:
  - (i) under subsection 247-20(3), the amount reasonably attributable to the cost of capital protection in an income year is the amount by which the total of the Capital Protection Fee and the interest incurred under the Loan for the income year exceeds the amount of the Loan multiplied by the adjusted loan rate at the time when the interest charge is first incurred during the term of the Loan, or the relevant part of the term (subsections 247-20(4) and 247-20(5))
  - (ii) the amount reasonably attributable to the cost of capital protection as worked out under paragraph 15(b)(i) of this Product Ruling, reduced by the Capital Protection Fee, is treated as a further cost of the Put Option under subsection 247-20(6). For the purposes of this Product Ruling, this further cost of the Put Option is referred to as the 'additional amount'
  - (iii) the additional amount (if any) and the Capital Protection Fee are not deductible under section 8-1, and
  - (iv) an amount equal to the interest incurred under the Loan, reduced by the additional amount (if any), will be deductible under section 8-1 to the extent that it does not correspond to the part of the Loan that is used to fund Brokerage.

- (c) Division 247 will not apply to the Interest Loan. An amount equal to the interest charged on the Interest Loan will be deductible under section 8-1.
- (d) Section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny deductibility of the interest incurred under the Loan and the Interest Loan (if applicable) that is allowable as a deduction under section 8-1.
- (e) Section 82KL of the ITAA 1936 will not apply to deny deductibility of the interest incurred under the Loan and the Interest Loan (if applicable) that is allowable as a deduction under section 8-1.
- (f) Section 82KZMF of the ITAA 1936 will not apply to set the amount and timing of deductions for prepaid interest incurred under the Loan and the Interest Loan (if applicable) that is allowable as a deduction under section 8-1.
- (g) Section 82KZM of the ITAA 1936 will not apply to deny the investor immediate deductibility of any part of the prepaid interest on the Loan and the Interest Loan (if applicable) allowable as a deduction under section 8-1, where at least one of the following applies for the year of income:
  - (i) the investor is a small business entity (as defined in subsection 328-110(1)) that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or
  - (ii) the investor is an individual who does not incur the interest in carrying on a business.
- (h) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions for the prepaid interest on the Loan and the Interest Loan (if applicable), allowable as a deduction under section 8-1 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.



- (i) For the purposes of the ITAA 1936 and ITAA 1997 (other than the purposes set out in subsection 235-815(2)) and pursuant to the operation of section 235-820, Securities held on trust for the investor by the Security Trustee as security for the Loan and, if applicable, the Interest Loan will be treated as being the investor's asset (instead of an asset of the Separate Trust), and any act done in relation to the Securities by the Security Trustee will be treated as if the act had been done by the investor (instead of the Security Trustee).
- (j) Any dividends or distributions paid on the Securities while the Securities are held on trust for the investor by the Security Trustee, including any dividend or distribution applied to reduce the Total Amount Owing on the Loan, will be included in the assessable income of the investor (and not the Security Trustee) under subsection 44(1) or paragraph 97(1)(a) of the ITAA 1936 (as applicable), as if the investor held the Securities directly.
- (k) The qualified person rules contained in former Division 1A of Part IIIA of the ITAA 1936 will apply to the investor directly (and not as a beneficiary of a trust) while the Securities are held on trust for the investor by the Security Trustee.
- (l) If the Closing Value of the Secured Property for the Loan on the Maturity Date is equal to or below the Loan principal advanced in respect of the relevant Parcel of Securities and the investor's Put Option is exercised, where the investor elects to have that Parcel sold to the Bank:
  - (i) CGT event A1 under section 104-10 will happen for the investor in relation to the Parcel of Securities
  - (ii) pursuant to subsection 134-1(1), the cost base and reduced cost base of the Parcel of Securities will include the cost of the Put Option, constituting:
    - the amount reasonably attributable to the cost of capital protection (as per paragraph 15(a)(ii) of this Product Ruling) where the cost of the Put Option is paid as a component of the interest rate charged on the Loan, or

- the Capital Protection Fee and the additional amount (if any) calculated under paragraph 15(b)(ii) of this Product Ruling), where the cost of the Put Option is paid as an upfront lump sum, and
- (iii) any capital gain or capital loss made by the investor on exercise of the Put Option will be disregarded under subsection 134-1(4).
- (m) Any capital gain realised by an investor on the disposal of a Parcel of Securities in the circumstances set out in paragraph 15(l) of this Product Ruling will be treated as a discount capital gain under section 115-5 where the investor is an individual, a complying superannuation entity or a trust and the disposal occurs more than 12 months after the acquisition of the Parcel of Securities by the investor.
- (n) If the Closing Value of the Secured Property for the Loan on the Maturity Date is above the Loan principal advanced in respect of the relevant Parcel of Securities and the investor's Put Option expires unexercised:
  - (i) CGT event C2 under paragraph 104-25(1)(c) will happen in relation to the Put Option for the investor, resulting in a capital loss equal to the reduced cost base of the Put Option under subsection 104-25(3), and
  - (ii) pursuant to section 110-55, the reduced cost base of the Put Option will include:
    - the amount reasonably attributable to the cost of capital protection (as per paragraph 15(a)(ii) of this Product Ruling) where the cost of the Put Option is paid as a component of the interest rate charged on the Loan, or
    - the Capital Protection Fee and the additional amount (if any) calculated under paragraph 15(b)(ii) of this Product Ruling, where the cost of the Put Option is paid as an upfront lump sum.
- (o) The grant of the right by the investor under the Reduced Rate Facility is a CGT event which does not result in a capital gain or loss to the investor.
- (p) The investor's legally enforceable right under the Reduced Rate Facility is a CGT asset under subsection 108-5(1). Payment by the investor of the Cash Settlement Amount under the Reduced Rate Facility will be included in the reduced cost base of the contractual right pursuant to section 110-55.

- (q) The commercial debt forgiveness rules in Division 245 will not apply to reduce the tax attributes of an SMSF Investor in relation to any debt forgiveness that arises because of the limited recourse nature of the Loan for the SMSF Investor.
- (r) Division 230 will not apply to any gains or losses with respect to the PEL where the investor is excepted from the Division pursuant to section 230-455.
- (s) The Application Fee incurred by the investor in respect of the Loan will be deductible under section 25-25.
- (t) The anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to deny deductibility of the interest incurred by the investor in respect of the Loan used to acquire a Parcel of Securities or in respect of the Interest Loan.

## Scheme

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 information received on 29 July 2013, 4 September 2013, 21 October 2016, 24 October 2016, 21 November 2016, 19 June 2019 and 2 August 2019
- Westpac Protected Equity Loan Product Disclosure Statement dated 22 July 2013, including the Terms and Conditions, as updated by Supplementary Product Disclosure Statements dated 30 May 2014 and 1 December 2015, and by the Notice to investors dated 12 November 2016, 30 October 2018 and 1 July 2019, and
- Deed Poll – Declaration of Trust (Trust Deed) executed on 19 April 2012, as amended by Amending Deed Poll dated 11 November 2016.

**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 and Trust Deed.

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

19. Following is a summary of the scheme:

- (a) The PEL is a loan facility which offers a Loan or Loans from the Bank for use by the investor to finance up to 100% of the purchase price of a Parcel or Parcels of Securities at Market Value, plus Brokerage, the Application Fee and any Adviser Service Fee. Where a Loan finances less than 100% of the purchase price of a Parcel of Securities, the investor is required to make a capital contribution equal to the difference between the price of the Parcel at inception (plus Brokerage, the Application Fee and any Adviser Service Fee) and the amount borrowed in respect of the Parcel.
- (b) The Securities are selected by the investor from a range of CHESS Approved Securities listed by the Bank in the Approved Securities List. Securities can only form part of the same Parcel if they are identical to each other. A separate Loan will be advanced in respect of each Parcel of Securities and interest and other costs will be calculated separately in respect of each Loan.
- (c) The Term of a Loan can be up to and including five years, or such longer period as agreed between the investor and the Bank. An application for one or more Loans must be in an aggregate amount of at least \$50,000, with each Loan in an amount of at least \$10,000 (or, in either case, such other amount as agreed by the Bank).
- (d) Each Parcel of Securities is held on Separate Trust by the Security Trustee on behalf of the investor and on the terms of the Trust Deed to secure the rights of the Bank under the Loan and, if applicable, the Interest Loan. To that end, the Security Trustee will grant a Security Interest to the Bank over the Secured Property to secure the investor's obligation to repay the Total Amount Owed on the Loan. The entire Security Interest granted to the Bank in relation to a Parcel of Securities will be discharged when it receives payment in full of the Total Amount Owed in respect of that Parcel.
- (e) The Interest Rate applicable to a Loan may be either a Fixed Rate for the entire Term of the Loan, or an Annually Resetting Rate which applies to an Interest Period of the Loan and may be reset annually to reflect market interest rates prevailing at the time.

- (f) There may be a different Interest Rate applicable to each Parcel of Securities, as determined by the Bank. The Bank may, however, apply a single Interest Rate across each of the investor's Loans under the PEL where the investor has acquired multiple Parcels of Securities; the Loans in respect of those Parcels have the same Term; and the cost of Capital Protection attributable to each Loan has been paid in the same way (see paragraph 19(k) of this Product Ruling). The single Interest Rate will be determined prior to drawdown of the Loans, or subsequently at the time of reset for Annually Resetting Rate Loans. The inclusion of Units in an ASX listed cash exchange traded fund as one of the Parcels of Securities may lower the weighted average interest rate on the Loans.
- (g) Interest on a Loan is payable annually in advance or monthly in arrears and is calculated by applying the applicable Interest Rate to the relevant Loan balance at the beginning of each Interest Period.
- (h) Investors who are not SMSF Investors and nominate to pay interest on their Loan annually in advance may also apply to procure an Interest Loan with the Bank for the purpose of funding the payment of prepaid interest on the Loan. The Term of each Interest Loan is limited to 12 months. Interest for the whole of the Term of the Interest Loan is payable in advance, at a Fixed Rate determined by the Bank. The Interest Loan principal is repayable in equal monthly instalments at the end of every month during the Term of the Interest Loan.
- (i) In consideration for the payment of the Capital Protection Fee for the Capital Protection offered under a Loan, the investor is granted a Put Option under which the investor has the right to require the Bank to purchase the Secured Property on the Maturity Date for an amount equal to the Loan Principal Outstanding where the Closing Value of the Secured Property for the Loan on the Maturity Date is equal to or less than the Loan principal advanced in respect of that Parcel. The amount of any capital contributed by the investor towards the purchase price of the Parcel of Securities is not protected in any way.
- (j) Where the Maturity Date occurs and the investor's Put Option is not exercised, the Put Option will expire.
- (k) The investor can elect to pay for the cost of the Put Option (the Capital Protection Fee) as an upfront lump sum, or as a component of the Interest Rate payable on the Loan.

- (l) The obligations of an investor (other than a SMSF Investor) in respect of a Loan and Interest Loan will be full recourse except to the extent that Capital Protection applies to the Loan Principal Outstanding at Maturity of the Loan. In the case of a SMSF Investor, the Bank's recourse against the investor to recover the Total Amount Owing will be limited to the Securities and any other Secured Property to which the Loan relates. However, the Bank will generally require the SMSF Investor in their personal capacity (if the investor is an individual trustee) or one or more of the SMSF Investor's members or directors (in the case of a corporate trustee) to provide a Guarantee and Indemnity, which will be full recourse such that if there is an amount outstanding to be paid to the Bank after the Bank has exercised its enforcement rights as mortgagee in relation to the relevant Securities and any other Secured Property to which the Loan relates, the Bank will be entitled to recover that amount from the Guarantor.
- (m) Investors may request to utilise a Reduced Rate Facility in relation to a Parcel of Securities under which:
  - (i) the investor grants the Bank a right to receive the Cash Settlement Amount if, at the Maturity Date of the Loan relating to that Parcel, the Closing Value of the Parcel exceeds the Cap Value nominated by the investor (which will be greater than the outstanding Loan amount). Any Cash Settlement Amount payable by the investor to the Bank will equal the sum of the excess of the Closing Value of the Securities in the Parcel over the Cap Value or, if a Participation Rate has been nominated, the excess of the Closing Value over the Cap Value less the amount determined by multiplying the Participation Rate by that excess, and
  - (ii) the amount of the Capital Protection Fee payable by the investor in relation to the Put Option (irrespective of the method chosen as per paragraph 19(k) of this Product Ruling) will be reduced in return for the investor granting the Bank's right to the Cash Settlement Amount.
- (n) At least five Business Days prior to Maturity the investor will receive a notice from the Bank under which the investor will need to select from one of the alternative methods available to settle each Loan. At Maturity, the Investor may:

- (i) have the Parcel of Securities transferred to them from the Security Trustee by repaying the Total Amount Owing (including any Cash Settlement Amount under a Reduced Rate Facility) using their own funds. If the Closing Value of the Secured Property for the Loan on the Maturity Date is equal to or less than the Loan principal, the Put Option will be exercised automatically and the Put Option cash settlement amount (being the difference between the Loan Principal Outstanding and the Closing Value of the Secured Property on the Maturity Date) will be set off against the Total Amount Owing for that Parcel. The investor will then pay the Bank the Closing Value of the Parcel of Securities,
  - (ii) have the Parcel of Securities sold to the Bank at the prevailing Market Value on the Maturity Date, apply the sale proceeds (net of any Brokerage) to repay the Total Amount Owing (including any Cash Settlement Amount payable under a Reduced Rate Facility) and keep any surplus. If the Closing Value of the Secured Property for the Loan on the Maturity Date is equal to or less than the Loan principal and the Put Option is exercised automatically, the Parcel of Securities will be sold to the Bank at a price equal to the aggregated Protection Level, and the Bank will apply this amount to repay the Loan principal in full (but not the balance of the Total Amount Owing which remains payable by the investor), or
  - (iii) apply to extend the Term of the Loan, or apply for a new Loan (if available), subject to the Bank's approval.
- (o) If the Bank does not receive the investor's selection within the required time or refuses the investor's request to either extend the existing Loan or be granted a new Loan, the investor will be deemed to have elected to have the Parcel of Securities sold as per paragraph 19(n)(ii) of this Product Ruling.
- (p) Investors will hold a Beneficial Interest in a Parcel of Securities purchased under the PEL whilst the Parcel is held by the Security Trustee, and any income derived from the Parcel shall be paid to the investor.

- (q) Investors are required to pay an Application Fee of up to 1.1% of the relevant Loan amount, as advised by the Bank, to the Bank upon successful application for a Loan. Brokerage, Taxes, costs, charges and commissions (if any) in relation to the purchase and sale of Securities, and the preparation of the PEL documentation, including any stamp duty and brokerage fees, are also payable by the investor.

### **Assumptions**

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

- (a) All investors are Australian residents for taxation purposes.
- (b) All SMSF Investors are regulated superannuation funds (as per section 19 of the SISA).
- (c) At all times during the scheme, where the Securities consist of units in a trust, the trust satisfies the requirements of subparagraph 82KZME(5)(b)(iii) of the ITAA 1936.
- (d) At all times during the scheme, where the Securities include a stapled security, the stapled security comprises shares and/or units that satisfy the requirements of subparagraph 82KZME(5)(b)(ii) and subparagraph 82KZME(5)(b)(iii) of the ITAA 1936, as applicable.
- (e) The Securities will be a share, unit in a unit trust or stapled security either listed for quotation in the official list of an approved stock exchange, or that meets the widely held requirements set out in the table contained in subsection 235-835(1)(b).
- (f) The Securities will not be ESS interests to which Subdivision 83A-B or 83A-C (about employee share scheme) applies.
- (g) At all times while the Security Trustee holds the Securities, the Securities will not be subject to any charge, security or other encumbrance (apart from any charge securing obligations relating to the Loan and, if applicable, the Interest Loan).
- (h) The investors will hold their interests in the Parcel(s) of Securities on capital account, are not traders in the Securities and are not treated for taxation purposes as trading in the Securities, carrying on a business of investing in the Securities, or holding the Securities as trading stock or a revenue asset.



- (i) The investors will hold the Put Option(s) on capital account, are not treated for taxation purposes as trading in the Put Option(s), carrying on a business of investing in the Put Option(s), or holding the Put Option(s) as trading stock or a revenue asset.
- (j) Loans made to SMSF Investors are covered by the exception in subsection 67A(1) of the SISA.
- (k) In respect of any interest to be paid in advance under the Loan or Interest Loan, these may be prepaid only in relation to a loan interest payment period of 12 months or less, and which ends on or before the last day of the income year following the expenditure year.
- (l) The dominant purpose of an investor in entering into the scheme is to derive assessable income from the Parcel(s) of Securities acquired with the proceeds of the Loan that exceeds the total expenses incurred. To that end, an investor's Portfolio will not consist of only one or more Parcels of Securities comprised of Units in an ASX listed cash exchange traded fund.
- (m) The investors have not made an election under subsection 230-455(7) to have Division 230 apply.
- (n) The investors will not be under any legal disability.
- (o) The scheme will be executed in the manner described in the Scheme section of this Product Ruling and the scheme documentation referred to in paragraph 16 of this Product Ruling.
- (p) All dealings by the investors, the Bank and the Security Trustee under the scheme will be at arm's length.

## 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.*

### **Section 8-1 and Division 247 – capital protected borrowings and deductibility of interest**

21. The interest paid on a borrowing used to acquire income producing assets such as Securities is generally treated as deductible under section 8-1 where it is expected that dividends, trust distributions or other 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*). However, the ability to claim interest deductions may be subject to Division 247.

22. Division 247 limits the allowable deductions for expenditure incurred under a 'capital protected borrowing'. Broadly, a capital protected borrowing arises where an amount is borrowed under an arrangement where the borrower is protected against the fall in value of some specified securities, and where that borrowing is made for the purpose of investing in those securities.

23. Division 247 applies to the Loan where the investor uses the Loan to acquire a Beneficial Interest in a Parcel of Securities and the investor is protected against the fall in the market value of the Parcel of Securities.

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

25. Where the Capital Protection Fee is factored into the interest rate charged on the Loan and there is no separate charge payable by an investor for the Put Option:

- the cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in paragraph 15(a)(ii) of this Product Ruling
- under step 1 of the method statement, the total amount incurred by the investor under or in respect of the Loan for the income year is the interest incurred on the Loan for the income year

- where the total amount incurred by the investor worked out under step 1 of the method statement is less than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, there is no amount reasonably attributable to the cost of capital protection. In these circumstances, the interest on the Loan will be fully deductible under section 8-1 to the extent that it does not correspond to the part of the Loan that is used to fund Brokerage
- where the total amount incurred by the investor worked out under step 1 of the method statement is greater than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, the balance is reasonably attributable to the cost of capital protection and is treated as if it were incurred for the Put Option (subsection 247-20(6)), and
- the investor's Put Option is a capital asset. Therefore, the amount reasonably attributable to the cost of capital protection is of a capital nature and not deductible under section 8-1.

26. Where the investor elects to pay the Capital Protection Fee as an upfront lump sum:

- the cost of capital protection is the amount worked out under the method statement in subsection 247-20(3), as set out in paragraph 15(b)(i) of this Product Ruling
- under step 1 of the method statement, the total amount incurred by the investor under or in respect of the Loan for the income year includes the interest incurred on the Loan and any amounts that are in substance for capital protection (such as the Capital Protection Fee) for the income year
- where the total amount incurred by the investor worked out under step 1 of the method statement is less than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, there is no amount reasonably attributable to the cost of capital protection. In these circumstances, the interest on the Loan will be fully deductible under section 8-1 to the extent that it does not correspond to the part of the Loan that is used to fund Brokerage

- where the total amount incurred by the investor worked out under step 1 of the method statement is greater than the total interest that would have been incurred by the investor worked out under step 2 of the method statement, the balance is reasonably attributable to the cost of capital protection. In calculating the additional amount (as per paragraph 15(b)(ii) of this Product Ruling), the amount reasonably attributable to the cost of capital protection will be reduced by the actual payment for a Put Option (the Capital Protection Fee) in accordance with subsection 247-20(6). The additional amount, to the extent that it is greater than zero, constitutes a further cost of capital protection in addition to the Capital Protection Fee, and
- the investor's Put Option is a capital asset. Therefore, the Capital Protection Fee and the additional amount (if any) are of a capital nature and not deductible under section 8-1.

27. Where an investor has acquired multiple Parcels of Securities and the Bank has applied a single Interest Rate across the Portfolio, the investment will be treated as one arrangement for the purposes of Division 247. However, as there is a separate Put Option provided in respect of each Parcel of Securities in the Portfolio, the cost of the investor's Capital Protection will need to be reasonably apportioned to each Put Option having regard to the size of each Parcel.

28. There is no element of capital protection connected with the Interest Loan. No part of the interest incurred by the investor on the Interest Loan for the income year will therefore be attributable to the cost of capital protection and the interest on the Interest Loan will be fully deductible under section 8-1.

### **Section 51AAA**

29. By acquiring a Parcel or Parcels of Securities, it is contemplated that an investor will derive assessable income by way of the receipt of dividend income and/or trust income and capital gains. As interest incurred on the Loan and Interest Loan would have been deductible under section 8-1 notwithstanding the inclusion of a net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to an investor who enters into the PEL.

### **Section 82KL**

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

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

31. 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 the carrying on of 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 that are of a capital nature.

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

32. 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:

- the investor carried on a business in the previous income year and the aggregated turnover for that year was less than \$10 million
- the aggregated turnover for the current year is likely to be less than \$10 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 \$10 million, or
- the aggregated turnover for the current year, worked out as at the end of the year is less than \$10 million.

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

33. The interest charged on the Loan and the Interest Loan that is deductible under section 8-1 is 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 of a loan 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 and, in respect of the Loan, not to the period of the Loan.

***Sections 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ style arrangements***

34. 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’ style arrangement for the doing of a thing that is not to be wholly done within the expenditure year.

35. For the purposes of section 82KZME of the ITAA 1936, ‘agreements’ are broadly defined to include an entire scheme of which a contract may form part. Under subsection 82KZME(4) of the ITAA 1936, the relevant agreement is all the contractual arrangements and activities associated with the participation in the PEL, including the financing, Securities acquisition and Securities disposal arrangements.

36. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude interest payable under the Loan and Interest Loan from the operation of section 82KZMF of the ITAA 1936 where:

- the prepaid interest expenditure under the Loan and Interest Loan is incurred in respect of money borrowed to acquire Securities that are as described in subparagraphs 82KZME(5)(b)(ii) and 82KZME(5)(b)(iii) of the ITAA 1936
- the investor can reasonably be expected to obtain dividends or 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 PEL are conducted at arm’s length.

37. Deductibility of the prepaid interest must therefore be considered under the prepayment rules contained in paragraphs 38 to 43 of this Product Ruling.

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

38. 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.

39. The expenditure must not be excluded expenditure. 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.

40. As the eligible service period in relation to the deductible interest payment under the Loan and Interest Loan is not more 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 a small business entity for the year of income that have not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or to investors who are individuals where the expenditure is not incurred in carrying on a business. Investors who satisfy these tests will be able to claim an immediate deduction allowable under section 8-1 for the interest incurred under the Loan and Interest Loan.

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

41. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure for an investor (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.

42. 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 to be wholly done within the expenditure year.

43. For these investors, the amount of prepaid interest incurred under the Loan and Interest Loan which is allowable as a deduction under section 8-1 will be apportioned over the relevant interest payment period.

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

44. 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).

45. Each Separate Trust created under the terms of the Trust Deed for the purposes of holding a Parcel of Securities on trust by the Security Trustee as trustee for an investor (other than a SMSF Investor), will be an instalment trust pursuant to paragraph 235-825(1)(a) on the basis that they will be covered by section 235-830 (about instalment trust arrangements), and satisfy the requirements in section 235-835 (about the type of asset being held on trust).

46. Each Separate Trust created under the terms of the Trust Deed for the purposes of holding a Parcel of Securities of a SMSF Investor on trust by the Security Trustee as trustee for a SMSF 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).

### **Dividends and distributions**

47. Pursuant to the operation of section 235-820 (as per paragraphs 15(i) and 44 to 46 of this Product Ruling):

- (a) all dividends and distributions paid in respect of a Parcel of Securities held on trust for the investor by the Security Trustee, including any dividends or distributions applied toward repayment of the investor's Total Amount Owing, will be included in the assessable income of the investor (and not the Security Trustee) under subsection 44(1) or paragraph 97(1)(a) of the ITAA 1936, as applicable, and
- (b) all franking credits attached to franked distributions made in respect of a Parcel of Securities held on trust for the investor by the Security Trustee will be taken to have flowed directly to the investor (instead of indirectly through the Separate Trust). In determining whether the investor is entitled to an offset under Division 207 in respect of franking credits received, the qualified person rules in former Division 1A of Part IIIAA of the ITAA 1936 are applied to the investor directly rather than as a beneficiary of a trust.



**Part 3-1 – application of CGT provisions to the Securities and the Put Option**

48. If an investor's Put Option is exercised and the investor elects to have the relevant parcel of Securities sold to the Bank, CGT event A1 will arise for the investor in respect of the disposal of the Parcel of Securities (section 104-10). Under item 2 of the table in subsection 134-1(1), the investor's cost base and reduced cost base of the Parcel of Securities will include the cost of the Put Option as worked out under Division 247 plus the Capital Protection Fee (where paid as an upfront lump sum). Any capital gain or capital loss made by the investor on the exercise of the Put Option will be disregarded (subsection 134-1(4)).

49. Division 115 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5, any capital gain realised by an investor on the sale of a Parcel of Securities will be treated as a discount capital gain where the investor is an individual, a complying superannuation entity or a trust and has held the Parcel of Securities for more than 12 months (excluding the days of acquisition and disposal).

50. Where the Put Option expires unexercised, CGT event C2 will arise for the investor in relation to the Put Option at that time (section 104-25). As the investor will not receive any capital proceeds in respect of the expiry of the Put Option, a capital loss will be made by the investor in this regard, equal to the investor's reduced cost base in the Put Option. Under section 110-55, the reduced cost base of the Put Option will include its cost as worked out under Division 247 plus the Capital Protection Fee (where paid as an upfront lump sum).

**Reduced Rate Facility**

51. The grant of a right by the investor to the Bank under the Reduced Rate Facility, that is, the Bank's right to a Cash Settlement Amount, gives rise to a CGT event D1 under section 104-35. This event will not result in a capital gain or loss arising for the investor (paragraph 116-30(3)(b)).

52. Under subsection 108-5(1) a CGT asset is any kind of property or a legal or equitable right that is not property. The right of an investor under the Reduced Rate Facility, that is, the right to a reduced Capital Protection Fee, is a legally enforceable right and therefore a CGT asset according to the definition in subsection 108-5(1).

53. At Maturity, the investor's ownership of the contractual right under the Reduced Rate Facility is discharged or satisfied. This discharge or satisfaction of the contractual right gives rise to CGT event C2 (paragraph 104-25(1)(b)).

54. Any Cash Settlement Amount paid by the investor under the Reduced Rate Facility, that is the difference between the Closing Value of the Parcel of Securities on the Maturity Date and the Cap Value, is capital expenditure made to acquire the contractual right referred to in paragraph 52 of this Product Ruling and will be included in the investor's reduced cost base in that CGT asset (section 110-55). The investor will make a capital loss from this CGT event equal to the reduced cost base of their right under the Reduced Rate Facility.

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

55. If an SMSF Investor fails to repay the Loan (or satisfy any of its obligations under the PEL), the Bank will be entitled to call on the Guarantee and Indemnity for this shortfall and will seek to recover the amount from the Guarantor. In this regard, any payment by the Guarantor to the Bank will meet the liability of the SMSF Investor to the Bank. Accordingly, there should be no forgiveness of a debt by the Bank for the purposes of Division 245 in these circumstances (section 245-35).

#### **Division 230 – Taxation of financial arrangements**

56. Division 230 sets out the tax treatment of gains or losses from a 'financial arrangement'. 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 apply to financial arrangements has not been made, then pursuant to section 230-455, Division 230 does not apply in relation to gains or losses from a financial arrangement held by:

- an individual, or
- 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
- an ADI, a securitisation vehicle or other financial sector entity with an aggregated turnover of less than \$20 million, or
- another entity with an aggregated turnover of less than \$100 million, financial assets of less than \$100 million and assets of less than \$300 million.

## **Section 25-25 – Application Fee**

57. The Application Fee incurred by an investor upon successful application for a Loan will be an allowable deduction pursuant to section 25-25 because it is a cost of borrowing money which is used for the purpose of producing assessable income. The Application Fee will be deductible on a straight line basis over the period of the shorter of:

- the term of the Loan, or
- five years.

## **Part IVA – anti-avoidance**

58. Provided that the scheme ruled on is entered into and carried out as described in this Product 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

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

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