


PR 2008/49 - Income tax: tax consequences of investing in ABN AMRO Unlisted Rolling Instalment Warrants 2007 Product Disclosure Statement (Cash Applicants) - Navra Blue Chip Australian Share Retail Fund

 This cover sheet is provided for information only. It does not form part of *PR 2008/49 - Income tax: tax consequences of investing in ABN AMRO Unlisted Rolling Instalment Warrants 2007 Product Disclosure Statement (Cash Applicants) - Navra Blue Chip Australian Share Retail Fund*



Product Ruling

Income tax: tax consequences of investing in ABN AMRO Unlisted Rolling Instalment Warrants 2007 Product Disclosure Statement (Cash Applicants) – Navra Blue Chip Australian Share Retail Fund

Contents Para

LEGALLY BINDING SECTION:

What this Ruling is about 1

Date of effect 8

Ruling 15

Scheme 16

NOT LEGALLY BINDING SECTION:

Appendix 1:

Explanation 22

Appendix 2:

Detailed contents list 60

❗ 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, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are 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 Tax Office **does not** sanction or guarantee this product. Further, we give 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. We recommend a financial (or other) adviser be consulted for such information.

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

Terms of use of this Product Ruling

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

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified in the Ruling part apply to the defined class of entities who participate in the scheme to which this Product Ruling relates.
2. In this Product Ruling this scheme is referred to as the ABN AMRO Australia Pty Limited Unlisted Rolling Instalment Warrants (Cash Applicants) over units in the Navra Blue Chip Australian Share Retail Fund (the Instalments).

Class of entities

3. The class of entities who can rely on this Product Ruling consists of those entities who apply as Cash Applicants and are accepted to participate in the scheme specified below on or after the date this Product Ruling is published and which execute the relevant agreements mentioned in paragraph 16 of this Ruling on or before 30 June 2010. They must 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 deriving assessable income from this involvement. These entities are referred to as Holder/s.

Superannuation Industry (Supervision) Act 1993

4. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA 1993). The Tax Office 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 1993.

Qualifications

5. 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 21 of this Ruling.
6. 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.

7. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Attorney General's Department
Robert Garran Offices
National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

8. This Product Ruling applies prospectively from 21 May 2008, the date this Ruling is published. It therefore applies to the specified class of entities that enter into the scheme from 21 May 2008 until 30 June 2010, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application for schemes entered into during the period of application.

9. 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;
- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Product Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Product Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Product Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Changes in the law

12. On 13 May 2008, the Treasurer announced that the Government will amend the benchmark interest rate in the capital protected borrowing rules from the Reserve Bank of Australia's indicator variable rate for personal unsecured loans (referred to in this ruling) to the Reserve Bank of Australia's indicator variable rate for standard housing loans for capital protected borrowings entered into after 7:30pm (AEST) on 13 May 2008. This change will affect the benchmark interest rate referred to in this Product Ruling.

13. As the proposed law has not been enacted, we cannot give a legally binding ruling on this change until the relevant legislation is enacted. Once the change is enacted, this Product Ruling will be amended and reissued to reflect the change in the law.

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 Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling is issued.

Ruling

15. Subject to the assumptions in paragraph 21 of this Ruling:
- (a) the Interest Amount, reduced by an amount reasonably attributable to the cost of capital protection under step 3 of the method statement in subsection 247-20(3) of the *Income Tax Assessment Act 1997* (ITAA 1997) will be deductible under section 8-1 of the ITAA 1997;
 - (b) under subsection 247-20(3) of the ITAA 1997 the amount reasonably attributable to the cost of capital protection in an income year, is the amount by which the Interest Amount incurred by the Holder under or in respect of the capital protected borrowing exceeds an amount representing the interest that would have been incurred for the income year on the Loan Amount if the following interest rates applied:
 - where interest is charged on the Loan Amount at a fixed rate for all or part of the term of the borrowing, the Loan Amount multiplied by the Reserve Bank of Australia's indicator variable rate for personal unsecured loans (benchmark rate) at the time when the Interest Amount is paid during the term of the borrowing, or the relevant part of the term; and

- where interest is charged on the Loan Amount at a variable rate for all or part of the term of the borrowing, the Loan Amount multiplied by the average of the benchmark rates published by the Reserve Bank of Australia during the term of the borrowing, or the relevant part of the term;
- (c) the amount reasonably attributable to capital protection (if any) under Division 247 of the ITAA 1997, as worked out under paragraph 15(b) of this Ruling, is not deductible under section 8-1 of the ITAA 1997 as it represents the cost of the Holder's Put Option;
- (d) section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny a Holder a deduction for the interest that is allowable under section 8-1 of the ITAA 1997;
- (e) section 82KL of the ITAA 1936 will not apply to deny deductibility for the interest that is allowable under section 8-1 of the ITAA 1997;
- (f) 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;
- (g) section 82KZM of the ITAA 1936 will not apply to deny immediate deductibility for the prepaid interest that is allowable under section 8-1 of the ITAA 1997 incurred by the Holder under the Instalments where at least one of the following applies for the year of income;
 - (i) the Holder is a small business entity; or
 - (ii) the Holder is an individual who does not incur the expenditure 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 that is allowable under section 8-1 of the ITAA 1997 (other than a small business entity for the year of income) who is a taxpayer that is not an individual and does not carry on a business;
- (i) The Borrowing Fee paid by the Holder on issue/acquisition of the Instalments as a component of the First Payment will be deductible under section 25-25 of the ITAA 1997;
- (j) if the Holder's Put Option is exercised, the cost of capital protection as worked out according to paragraph 15(b) of this Ruling forms part of the cost base and the reduced cost base of the Underlying Units pursuant to section 134-1 of the ITAA 1997. Any capital gain or capital loss on exercise of the Put Option will be disregarded;

- (k) if the Holder's Put Option is not exercised, the cost of capital protection as worked out according to paragraph 15(b) of this Ruling forms part of the reduced cost base of the Holder's Put Option under section 110-55 of the ITAA 1997;
- (l) for capital gains tax (CGT) purposes the date of acquisition of the beneficial interest in the Underlying Units is the date when the application is accepted by ABN AMRO Australia Pty Limited (ABN AMRO), being the Issue Date pursuant to subsection 109-5(2) of the ITAA 1997;
- (m) no CGT event happens when legal title to the Underlying Units is transferred by the Trustee to the Holder on completion of the Instalments pursuant to paragraph 104-10(7)(a) of the ITAA 1997;
- (n) the Holder's cost base or reduced cost base in the Underlying Units will include the Loan Amount and incidental costs of acquisition and disposal pursuant to section 110-25 or 110-55 of the ITAA 1997 respectively;
- (o) a CGT event will happen in relation to the Underlying Units under section 104-10 of the ITAA 1997 for the Holder where either:
 - (i) the Holder exercises the Holder's Put Option; or
 - (ii) the Holder does nothing at the Expiry Date and the Underlying Units is sold by the Trustee exercising its power of sale under the Security Interest.

Where either of the above scenarios occur at the Expiry Date and the sale proceeds are insufficient to repay the Loan, ABN AMRO has no recourse against the Holder to recover the shortfall. In these circumstances the Holder will need to reduce the cost base of the Underlying Units by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997;

- (p) any capital gain made by a Holder on the sale of an Underlying Unit received pursuant to completion of an Instalment, will be treated as a discount capital gain under section 115-5 of the ITAA 1997 where the Holder is an individual, a complying superannuation entity, or a trust and the sale occurs more than 12 months after the Issue Date;
- (q) a CGT event will happen under section 104-25 of the ITAA 1997 on the Expiry Date if the Holder's Put Option is not exercised. The capital proceeds received when the Holder's Put Option is not exercised will be nil and the Holder will make a capital loss equal to the reduced cost base of the Holder's Put Option;

- (r) the Holders of the Instalments, not the Trustee, are assessable under section 97 of the ITAA 1936 on all of the income derived from the Underlying Units while the Underlying Units are the subject of the Separate Trusts, including dividends and any Accretion representing a Distribution which is applied to reduce the Loan;
- (s) the commercial debt forgiveness rules in Schedule 2C of the ITAA 1936 will not reduce the tax attributes of a Holder in relation to any debt forgiveness that arises because of the limited recourse nature of the Loan; and
- (t) the anti-avoidance provisions contained in Part IVA of the ITAA 1936 will not apply to a Holder in respect of Instalments.

Scheme

16. The scheme that is the subject of this Product Ruling is described below. The scheme is incorporated within the following documents:

- application for a Product Ruling dated 15 January 2008 received from Allens Arthur Robinson on behalf of ABN AMRO;
- the Product Disclosure Statement (PDS) dated 30 November 2007 which contains a summary of the terms of the Loan to be entered into by ABN AMRO and a Holder;
- the NavraInvest Product Disclosure Statement dated 1 July 2007 which contains a summary of the Navra Blue Chip Australian Share Retail Fund which is the Underlying Fund that Holders invests in;
- a copy of the Deed Poll executed by ABN AMRO (as the Issuer and Lender) and ABNED Nominees Pty Limited (as the Trustee);
- NavraInvests' Top 20 unit holders as at 8 February 2008;
- a copy of the consolidated Deed Poll dated 14 April 2003 (Original Constitution) for the Navra Blue Chip Australian Share Retail Fund as amended by the First Supplemental Deed Poll dated 28 April 2003 (Supplemental Deed); and
- further information provided on 12 February 2008, 6 March 2008, 9 April 2008 and 18 April 2008.

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. The documents highlighted are those that a Holder may enter into. 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 a Holder or any associate of a Holder, will be a party to, which are a part of the scheme. The effect of these agreements is summarised as follows.

18. In this Ruling, unless otherwise defined, capitalised terms take their meaning as per the PDS.

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

Overview

20. Following is a summary of the scheme:

- (a) on acceptance of a Holder's application for an Instalment, the Holder enters into the limited recourse Loan with ABN AMRO and appoints ABNED Nominees Pty Limited to act as Trustee;
- (b) the Holder uses the Loan from ABN AMRO to acquire units in the Navra Blue Chip Australian Share Retail Fund (the 'Underlying Units'). The Underlying Units include Accretions conferred in respect of those units. The Holder will be registered as the holder of the Instalments and will have a beneficial interest in the Underlying Units. The legal title to the Underlying Units will be held by the Trustee subject to a Security Interest;
- (c) the Cash Applicant pays the First Payment to ABN AMRO. On the Issue Date, ABN AMRO lends the Loan Amount. The Cash Applicant directs ABN AMRO to pay the Loan Amount, together with the First Payment, to the Trustee to be applied by the Trustee in the following manner for each Instalment applied for:
 - (i) the Loan Amount and part of the First Payment will be applied to acquire the Underlying Units, and
 - (ii) the remainder of the First Payment will be paid to ABN AMRO in payment of any Interest Amount and Borrowing Fee;
- (d) the Holder acquires the Holder's Put Option which can only be invoked on the Expiry Date;
- (e) the term of an Instalment will be up to 3 years;

- (f) the Instalment will not be tradeable on the ASX;
- (g) the amount of the Loan provided to fund the purchase of each Underlying Unit will be fixed by ABN AMRO on acceptance of an application based on the market value of the Underlying Units at that time;
- (h) repayment of the Loan will be secured by a Security Interest or 'charge' over the Underlying Units. The Underlying Units will be held by the Trustee on trust for the Holder. Each trust and each Underlying Unit to which it relates will be kept as a Separate Trust and there will be no pooling of interests or property to which the trust relates;
- (i) the Loan is made on a limited recourse basis. Under the Loan Agreement ABN AMRO's ability to recover the Loan Amount from the Holder is limited to the amount received by ABN AMRO either:
 - (i) if the Holder's Put Option is exercised by the Holder – the amount payable under the Holder's Put Option (this amount is the Exercise Price); or
 - (ii) if the Holder's Put Option is not exercised by the Holder – the amount recoverable by ABN AMRO on the enforcement of its rights in respect of the Underlying Units;
- (j) On each Reset Date, the Loan Amount may be varied (Revised Loan Amount) to cover the Interest Amount for the next Rollover Period. No Borrowing Fee will be charged in relation to the next Rollover Period. The Holder will not have to take any action as the Trustee will manage the Loan drawdown and the payment of these amounts.
- (k) interest on the Loan is prepaid annually, and is charged at either a fixed or variable rate. The interest is payable on Application and on each 30 June (each a Reset Date) as a component of the Interest Amount;
- (l) the Borrowing Fee relates to the cost to ABN AMRO of providing the Loan. The Borrowing Fee is paid by the Holder on issue/acquisition of the Instalment as a component of the First Payment;
- (m) ABN AMRO will not charge any Capital Protection Fee for providing the Holder's Put Option;
- (n) Distributions received in respect of the Underlying Units will either:
 - (i) be distributed to the Holder; or

- (ii) where the distribution is attributable to a Corporate Action, the Holder will direct the Trustee to apply that Holder's entitlement to the distribution in a manner nominated by the Issuer, including to partially repay the Loan;
- (o) at the Expiry Date, the Holder has a number of options, including:
 - (i) pay the Instalment Payment:

Holders can obtain the Underlying Units by paying an amount equal to the aggregate of the Loan Amount (the 'Instalment Payment') and Transfer Tax payable (if any). When this amount is made the Loan is repaid, the Security Interest is discharged, the Underlying Units are delivered to the Holder and the Holder's Put Option expires;
 - (ii) exercise the Holder's Put Option:

ABN AMRO must purchase the Underlying Units for the Exercise Price. The proceeds are applied to repay the Loan and the Security Interest is released;
 - (iii) roll the Instalments into another Series (if available); or
 - (iv) do nothing:

If the Holder does none of the above actions the Trustee will sell the Underlying Units and any proceeds after payment of the Loan Amount and other costs incurred by ABN AMRO or the Trustee in selling the Underlying Units, will be paid to the Holder. The Holder's Put Option will expire.

Assumptions

21. This ruling is made on the basis of the following necessary assumptions:

- (a) all of the Holders are Australian residents for taxation purposes;
- (b) the Holders are not traders in investments and are not treated for taxation purposes as trading in the Underlying Units, carrying on a business of investing in the Underlying Units, or holding the Underlying Units as trading stock or as a revenue asset;

- (c) in respect of any interest charges to be paid in advance, these may be prepaid, but only in relation to loan interest payment periods of 12 months or less that end on or before the last day of the income year following the expenditure year;
- (d) at the time of the prepayment of the Interest Amount the Navra Blue Chip Australian Share Retail Fund trust will have at least 300 unit holders;
- (e) the dominant purpose of a Holder in entering the arrangement is to derive assessable income from their investment in the Instalments;
- (f) the arrangement will be executed in the manner described in the Scheme section of the Ruling;
- (g) all dealings between the Holders and ABN AMRO will be at arm's length; and
- (h) the Underlying Units will not be the subject of any securities lending arrangement entered into by or on behalf of the Holder.

Commissioner of Taxation21 May 2008

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 – deductibility of interest and capital protected borrowings

22. The 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 of the ITAA 1997 where it is expected that distributions or other assessable income would be derived from the investment (see Taxation Ruling TR 95/33).

23. Division 247 of the ITAA 1997 applies to an Instalment as a capital protected borrowing because:

- the Holder uses the Loan Amount to acquire a beneficial interest in Underlying Units comprising a unit in a unit trust, and the Holder is protected against the fall in the market value of the Underlying Units; and
- the units in the unit trust are not listed for quotation on the ASX and the unit trust is a widely held unit trust as defined in section 272-105 in Schedule 2F to the ITAA 1936.

24. Division 247 of the ITAA 1997 sets out a methodology for reasonably attributing the cost of capital protection incurred by a borrower under a capital protected borrowing. Division 247 ignores any amount (such as any Borrowing Fee) which is not in substance for capital protection or interest, in calculating the cost of capital protection.

25. The amount reasonably attributable to the cost of capital protection is worked out under the method statement in subsection 247-20(3) of the ITAA 1997, as set out in paragraph 15(b) of this ruling.

26. For a Holder of an Instalment, the Holder's Put Option is a capital asset. As the cost of capital protection is the cost of the Holder's Put Option, this expense is capital in nature. The Interest Amount will be deductible under section 8-1 of the ITAA 1997 only to the extent that it is not for the cost of capital protection.

Section 51AAA

27. By acquiring Instalments, it is contemplated that a Holder will derive assessable income by way of the receipt of trust distributions (which may include capital gains), and in due course capital gains in respect of the Underlying Units. As interest would have been deductible under section 8-1 of the ITAA 1997 notwithstanding the inclusion of any net capital gain in assessable income, section 51AAA of the ITAA 1936 has no application to a Holder acquiring Instalments.

Section 82KL

28. The operation of section 82KL of the ITAA 1936 depends, amongst 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 of the ITAA 1997.

Subdivision H of Division 3 of Part III

29. Subdivision H of Division 3 of Part III of the ITAA 1936 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 Holder is a 'small business entity', whether the Holder is an individual and whether the Holder 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 entity

30. Under Subdivision 328-C of the ITAA 1997, an Investor will be a small business entity for an income year if the Investor carries on a business and either:

- the Investor carried on a business in the previous income year and the Investor's aggregated turnover for the previous year was less than \$2 million; or
- the Investor's aggregated turnover in the current income year is likely to be less than \$2 million.

The eligible service period for the purposes of Subdivision H of Division 3 of Part III

31. The interest allowable under section 8-1 of the ITAA 1997 is in relation to a prepayment of loan interest for a period that is not more than 12 months. 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 of Division 3 of Part III of the ITAA 1936, 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 or less, and not the period of the Loan.

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

32. 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.

33. 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’ is all the contractual arrangements and activities associated with the participation in the Instalments including the financing, unit purchase, unit holding and disposal arrangements.

34. Under the arrangement, when the Holder acquires an Instalment, they acquire beneficial ownership of the Underlying Units.

35. Exception 1, as contained in subsection 82KZME(5) of the ITAA 1936, applies to exclude the interest incurred on borrowings under the Instalment from the operation of section 82KZMF of the ITAA 1936, as:

- the documents and facts described in the scheme at paragraphs 16 to 21 of this Ruling establish that Holders have fixed entitlements to all of the income and capital of the Navra Blue Chip Australian Share Retail Fund trust. Therefore, the prepaid interest expenditure under the Instalment is incurred in respect of money borrowed to acquire units in a trust as described in subparagraph 82KZME(5)(b)(iii) of the ITAA 1936;
- the Holder can reasonably be expected to obtain trust income from the investment;
- the Holder will not obtain any other kind of assessable income from the investment, except possibly in due course capital gains; and
- all aspects of the Instalment are at arm’s length.

36. Deductibility of expenditure must therefore be considered under the prepayment rules outlined in paragraphs 37 to 42 of this Ruling.

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

37. 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; or
- a taxpayer that is an individual and the expenditure is not incurred in carrying on a business.

38. 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.

39. As the eligible service period in relation to the deductible interest for an Instalment 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 Holders who are small business entities for the year of income, or to Holders who are individuals and the expenditure is not incurred in carrying on a business. Holders who satisfy these tests will be able to claim an immediate deduction for the interest incurred.

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

40. Section 82KZMD of the ITAA 1936 sets the amount and timing of deductions for expenditure for a Holder (other than a small business entity for the year of income) that is not an individual and does not incur the expenditure in carrying on a business.

41. Section 82KZMA of the ITAA 1936 requires that 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.

42. For these taxpayers, the deduction allowable under section 8-1 of the ITAA 1997 for Interest Amount on the Instalments will be apportioned on a straight line basis over the period to which it relates.

Section 25-25 – Borrowing Fee

43. The Borrowing Fee may be charged at the discretion of ABN AMRO for making the Loan by way of a single payment at the time of a Cash Application. The Borrowing Fee will be payable as a component of the First Payment. No part of the Borrowing Fee charged is a payment for the purchase of the Holder's Put Option. The Borrowing Fee will be an allowable deduction pursuant to section 25-25 of the ITAA 1997. Each Borrowing Fee will be deductible on a straight line basis over the shorter of:

- the period of the loan as specified in the original loan contract;
- the period starting on the first day on which the money was borrowed and ending on the day the loan is repaid; or
- 5 years starting on the first day on which the money was borrowed.

If a Borrowing Fee is \$100 or less, the Borrowing Fee will be fully deductible in the year in which it is incurred.

Sections 110-25, 110-55 and 134-1 – cost base of the Holder's Put Option and Underlying Units

44. If the Holder exercises the Put Option and transfers the Underlying Units to ABN AMRO, any capital gain or capital loss on the exercise of the Put Option is disregarded. The cost of capital protection will form part of the second element of the Holder's cost base for the Underlying Units under item 2 of subsection 134-1(1) of the ITAA 1997.

45. If the Holder's Put Option is not exercised the cost of capital protection forms part of the reduced cost base of the Holder's Put Option under section 110-55 of the ITAA 1997.

46. The Holder's cost base or reduced cost base in the Underlying Units will include the Loan Amount and incidental costs incurred by the Holder in acquiring and disposing of the Underlying Units (this includes stamp duty and costs of transfer) pursuant to section 110-25 and 110-55 of the ITAA 1997.

Section 109-5 – time of acquisition of the Underlying Units

47. Section 109-5 of the ITAA 1997 applies to Holders to treat them as having acquired the Underlying Units at the time when the Holder obtains the beneficial ownership of the Underlying Units. The acquisition time is the time the Holder's application was accepted by ABN AMRO (being the Issue Date).

Paragraph 104-10(7)(a) – no CGT event when Instalment Payment is paid

48. When an Instalment Payment is made, no CGT event will arise in respect of the transfer of legal title to the Underlying Units from the Trustee to the Holder by virtue of paragraph 104-10(7)(a) of the ITAA 1997.

Section 104-10 and subsection 110-45(3) – CGT event A1

49. CGT event A1 will arise for the Holder if either the Holder exercises the Holder's Put Option or the Holder does nothing at the Expiry Date and the Underlying Units are sold by the Trustee as a result of the Lender exercising its Security Interest. If the sale proceeds are insufficient to repay the Loan, ABN AMRO has no recourse against the Holder to recover the shortfall. In this circumstance the Holder will need to reduce the cost base of the Underlying Units by the amount of the shortfall under subsection 110-45(3) of the ITAA 1997.

Section 115-5 – discount capital gains

50. Division 115 of the ITAA 1997 allows a taxpayer a discount on capital gains in certain circumstances. In accordance with section 115-5 of the ITAA 1997, any capital gain realised by a Holder on the sale of the Underlying Units pursuant to the completion of the Instalment, will be treated as a discount capital gain where the Holder is an individual, a complying superannuation entity or a trust and has held the Instalment for more than 12 months from the Issue Date.

Section 104-25 – CGT event C2

51. Where, at the Expiry Date, the Holder's Put Option ends and CGT event C2 is triggered, the capital proceeds received on the expiry of the Holder's Put Option will be nil.

52. The Holder will make a capital loss equal to the reduced cost base in the Holder's Put Option. Pursuant to section 110-55 of the ITAA 1997, the reduced cost base will include the cost of capital protection.

Section 97

53. The Holder is presently entitled to all of the income derived from the Underlying Units including trust distributions and Accretions that represent a Distribution which is applied to reduce the Loan. Therefore, section 97 of the ITAA 1936 will apply to assess the Holder on the income derived from the Underlying Units.

Schedule 2C – commercial debt forgiveness

54. Where the limited recourse feature of the Loan comes into effect, the Holder is not required to pay the Instalment Payment, and therefore there will be a commercial debt forgiveness under section 245-35 of Schedule 2C to the ITAA 1936. Under Schedule 2C where a forgiveness results in the Holder having a positive 'net forgiven amount', the Holder will be required to reduce certain tax attributes to the extent of the net forgiven amount.

55. To determine the net forgiven amount of a debt forgiveness it is first necessary to determine the 'gross forgiven amount'. In the Holder's circumstances Schedule 2C of the ITAA 1936 will have no practical effect as the gross forgiven amount in respect of the debt will be equal to zero. The gross forgiven amount is equal to the 'notional value' of the debt less any consideration paid or given in respect of the debt.

56. The notional value of the Instalment Payment debt is the lesser of the limited recourse debt outstanding at the time of the debt forgiveness and the market value of ABN AMRO's rights in relation to the Underlying Units at the time of the debt forgiveness, under section 245-60 of Schedule 2C of the ITAA 1936. The situation where the limited recourse feature of the Instalments may come into effect is where the market value of the Underlying Units will not cover the Instalment Payment. In such a situation the market value of ABN AMRO's rights in relation to the Underlying Units will arguably be no more than the market value of the Underlying Units at that point in time.

57. The consideration paid by a Holder in respect of the debt forgiveness would be equal to the market value of any property given by the Holder in respect of the debt forgiveness as determined at the time of the forgiveness, under paragraph 245-65(1)(b) of Schedule 2C of the ITAA 1936. Arguably, this market value is equal to the market value of ABN AMRO's rights in relation to the Underlying Units. Therefore the gross forgiven amount will be nil.

58. Accordingly, Schedule 2C of the ITAA 1936 will not reduce a Holder's tax attributes where the limited recourse feature of the Loan comes into effect.

Part IVA

59. Provided that the arrangement ruled on is entered into and carried out as described (see the Scheme part of this Ruling), it would be accepted as an ordinary commercial transaction and Part IVA of the ITAA 1936 would not apply.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Class of entities	3
Superannuation Industry (Supervision) Act 1993	4
Qualifications	5
Date of effect	8
Changes in the law	12
Note to promoters and advisers	14
Ruling	15
Scheme	16
Overview	20
Assumptions	21
Appendix 1 – Explanation	22
Section 8-1 and Division 247 – deductibility of interest and capital protected borrowings	22
Section 51AAA	27
Section 82KL	28
Subdivision H of Division 3 of Part III	29
<i>Subdivision 328-C – small business entities</i>	30
<i>The eligible service period for the purposes of Subdivision H of Division 3 of Part III</i>	31
<i>Sections 82KZME and 82KZMF – prepaid expenditure and ‘tax shelter’ arrangements</i>	32
<i>Section 82KZM – prepaid expenditure incurred by small business entities and individuals incurring non-business expenditure</i>	37
<i>Sections 82KZMA and 82KZMD – prepaid non-business expenditure incurred by non-individual and small business entities</i>	40
Section 25-25 – Borrowing Fee	43
Sections 110-25, 110-55 and 134-1 – cost base of the Holder’s Put Option and Underlying Units	44
Section 109-5 – time of acquisition of the Underlying Units	47
Paragraph 104-10(7)(a) – no CGT event when Instalment Payment is paid	48

Section 104-10 and subsection 110-45(3) – CGT event A1	49
Section 115-5 – discount capital gains	50
Section 104-25 – CGT event C2	51
Section 97	53
Schedule 2C – commercial debt forgiveness	54
Part IVA	59
Appendix 2 – Detailed contents list	60

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/33

Subject references:

- financial products
- interest expense
- interest income
- prepaid expenses
- product rulings
- public rulings
- taxation administration

Legislative references:

- ITAA 1936 51AAA
- ITAA 1936 Pt III Div 3 Subdiv H
- ITAA 1936 82KL
- ITAA 1936 82KZL(1)
- ITAA 1936 82KZL(2)(a)
- ITAA 1936 82KZM
- ITAA 1936 82KZMA
- ITAA 1936 82KZMD
- ITAA 1936 82KZME
- ITAA 1936 82KZME(4)
- ITAA 1936 82KZME(5)
- ITAA 1936 82KZME(5)(b)(iii)
- ITAA 1936 82KZMF

- ITAA 1936 97
- ITAA 1936 Pt IVA
- ITAA 1936 Sch 2C
- ITAA 1936 Sch 2C 245-35
- ITAA 1936 Sch 2C 245-60
- ITAA 1936 Sch 2C 245-65(1)(b)
- ITAA 1936 Sch 2F 272-105
- ITAA 1997 8-1
- ITAA 1997 25-25
- ITAA 1997 104-10
- ITAA 1997 104-10(7)(a)
- ITAA 1997 104-25
- ITAA 1997 109-5
- ITAA 1997 109-5(2)
- ITAA 1997 110-25
- ITAA 1997 110-45(3)
- ITAA 1997 110-55
- ITAA 1997 Div 115
- ITAA 1997 115-5
- ITAA 1997 134-1
- ITAA 1997 134-1(1)
- ITAA 1997 Div 247
- ITAA 1997 247-20(3)
- ITAA 1997 Subdiv 328-C
- SISA 1993
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

ATO references

NO: 2008/956

ISSN: 1441-1172

ATOLaw topic: Income Tax ~~ Product ~~ finance