


PR 2024/6 - Tax consequences of investing in the Anadara Deferred Purchase Agreement

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Status: **legally binding**

Product Ruling

Tax consequences of investing in the Anadara Deferred Purchase Agreement

📌 Relying on this Ruling

This publication (excluding appendix) 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 this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Terms of use of this Ruling

This Ruling has been given on the basis that the entity who applied for the 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 Ruling.

Changes in the law

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 promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling has issued. Similarly, entities that are considering participating in the Scheme are advised to confirm with their tax adviser that changes in the law have not affected this Ruling since it was issued.

No guarantee of commercial success

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

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

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What this Ruling is about

1. This Ruling sets out the income tax consequences for entities that participate as an Investor in the scheme referred to as the Anadara Deferred Purchase Agreement (DPA), offered by Anadara Specialist Investments Pty Ltd (the Issuer) and arranged by Viriathus Capital Pty Ltd (the Arranger).
2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated. Terms which are defined in the Anadara Specialist Investments Pty Ltd Master Information Memorandum (Master IM) referred to in paragraph 11 of this Ruling have been capitalised.
3. This Ruling does not address:
 - the tax consequences of paying any fee (including any Application Fee) other than a loan establishment fee
 - the tax consequences of taking delivery of, holding and disposing of the Delivery Parcel
 - the tax consequences of a transfer or novation of an Investor's rights and obligations under the Terms
 - the tax consequences of
 - an Investor Insolvency
 - an exercise of the Annual Walk Away Option
 - an Early Maturity Event
 - an Issuer Buy-Back
 - an Adjustment Event, or
 - a Market Disruption Event
 - the tax consequences associated with the holding of a Beneficial Interest
 - the deductibility of interest where Units in a Series are acquired with an Investment Loan and the only type of Coupon payable under that Series is a Fixed Coupon
 - whether the scheme constitutes a deferred purchase agreement, and
 - whether the scheme constitutes a financial arrangement for the purposes of Division 230 (taxation of financial arrangements).

Who this Ruling applies to

4. This Ruling applies to you if you:
 - are accepted to participate in the scheme described in paragraphs 11 to 14 of this Ruling, as an Investor, and your rights and obligations under the Terms will commence on a relevant Commencement Date, being a Commencement Date on or between 1 September 2023 and 30 June 2026, and

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- at the time of entering into the scheme and on each Interest Payment Date thereafter have a
 - purpose of staying in the scheme until it is completed (that is, being a party to the Terms until their term expires), and
 - realistic expectation of deriving assessable income from the scheme that exceeds the deductible expenditure that you incur in respect of it.¹
5. This Ruling does not apply to you if you:
- are a non-resident for Australian tax purposes
 - are an entity whose rights and obligations under the Terms commence other than on a relevant Commencement Date (see paragraph 4 of this Ruling)
 - are an entity that, at the time of entering into the scheme and on each Interest Payment Date thereafter, intends to terminate your involvement in the scheme prior to its completion
 - are an entity that, at the time of entering into the scheme and on each Interest Payment Date thereafter, does not intend to derive assessable income from the scheme that exceeds the deductible expenditure that you incur in respect of it
 - trade in financial instruments or securities and are treated for tax purposes as trading in the Units or the Delivery Assets, carrying on a business of investing in the Units or the Delivery Assets, or holding the Units or Delivery Assets as trading stock or as revenue assets, or
 - are subject to Division 230 in respect of this scheme.

Requirements of the Superannuation Industry (Supervision) Act 1993

6. This Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993*. 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 Ruling as to whether investment in this scheme may contravene the provisions of the *Superannuation Industry (Supervision) Act 1993*.

Date of effect

7. This Ruling applies from 1 September 2023 to Investors specified in paragraph 4 of this Ruling who enter into the scheme described in paragraphs 11 to 14 of this Ruling on a relevant Commencement Date from 1 September 2023 until 30 June 2026.

8. However, the Ruling only applies and may be relied on to the extent that there is no change in the scheme or in the Investor's involvement in the scheme. If the scheme carried out is materially different from the scheme described at paragraphs 11 to 14 of this Ruling, this Ruling cannot be relied upon and may be withdrawn or modified.

¹ Income arising from any Delivery Assets delivered to the Investor at Maturity does not constitute 'assessable income from the scheme'.

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Ruling

9. Subject to paragraph 3 of this Ruling and the assumptions in paragraph 10 of this Ruling:

- (a) Any Coupons received by the Investor in respect of their Units under the DPA is income according to ordinary concepts and assessable income of the Investor under section 6-5 in the income year in which the Coupons are credited or received.
- (b) For Units in a Series that have the potential to pay Coupons
 - (i) Interest incurred by the Investor in respect of their Investment Loan under the DPA is deductible under section 8-1. This deduction is allowable in the income year incurred, subject to the application of the provisions discussed at subparagraphs 9(e) and (f) of this Ruling.
 - (ii) Section 51AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to deny the Investor a deduction for the interest incurred under the Investment Loan that is allowable as a deduction under section 8-1.
- (c) For Units in a Series that do not have the potential to pay Coupons, interest incurred by the Investor in respect of their Investment Loan is not deductible under section 8-1.
- (d) Section 82KL of the ITAA 1936 will not apply to deny the amount of interest under the Investment Loan that is allowable as a deduction under section 8-1.
- (e) Sections 82KZME and 82KZMF of the ITAA 1936 will apply to set the amount and timing of deductions for each Prepaid Interest amount which
 - (i) is allowable as a deduction under section 8-1
 - (ii) is not less than \$1,000
 - (iii) relates to a period extending beyond the end of the income year in which the Prepaid Interest is incurred, and
 - (iv) is incurred by an Investor whose allowable deductions that are attributable to the Units for the income year in which the Prepaid Interest is incurred exceeds the Investor's assessable income that is attributable to the Units for that same year.
- (f) Where sections 82KZME and 82KZMF of the ITAA 1936 do not apply to set the amount and timing of deductions for Prepaid Interest amounts incurred by the Investor
 - (i) Sections 82KZMA and 82KZMD of the ITAA 1936 will apply to set the amount and timing of deductions where the Prepaid Interest amount
 - is allowable as a deduction under section 8-1
 - is not less than \$1,000
 - relates to a period extending beyond the end of the income year in which the Prepaid Interest is incurred, and

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- is incurred by an Investor (other than a small business entity, or an entity covered by subsection 82KZMA(2A) of the ITAA 1936, for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure) that is not an individual and does not carry on a business.
- (ii) Section 82KZM of the ITAA 1936 will apply to set the amount and timing of deductions where the Prepaid Interest amount
- is allowable as a deduction under section 8-1
 - is not less than \$1,000
 - relates to either a period that is longer than 12 months or a period that is 12 months or shorter but ends after the last day of the year of income after the one in which the Prepaid Interest was incurred, and
 - is incurred by an Investor that is either a small business entity, or an entity covered by subsection 82KZM(1A) of the ITAA 1936, that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or an individual who doesn't incur the expenditure in carrying on a business.
- (g) The Investor's legally enforceable rights in respect of their Units under the Terms are, in their totality, a CGT asset under subsection 108-5(1).
- (h) The Investor's ownership of those contractual rights in respect of their Units under the DPA comes to an end by reason of those rights being discharged or satisfied upon either the application or payment of the Sale Monies from the sale of the Delivery Parcel under the Agency Sale Option, or the delivery of the Delivery Parcel to the Investor. A CGT event C2 happens under section 104-25 at this time.
- (i) The Investor's capital proceeds under section 116-20 from the CGT event will, as applicable, be equal to the Sale Monies obtained under the Agency Sale Option, or the market value of the Delivery Parcel received by the Investor on (or shortly after) the Settlement Date. For Units in a Series where the only payment receivable by the Investor on (or shortly after) the Settlement Date is a Performance Coupon (as a Final Coupon) the Investor's capital proceeds from the CGT event will be equal to the Performance Coupon.
- (j) Where part or all of the capital proceeds also represent Coupons received by an Investor and are included in assessable income under section 6-5, subsection 118-20(1) will apply to reduce any capital gain made by the Investor to nil if it does not exceed the amount included as assessable income.
- (k) The cost base or reduced cost base of the Investor's contractual rights in respect of their Units includes the Investment Amount (subsections 110-25(2) and 110-55(2)). The cost base of the Investor's contractual rights in respect of their Units in a Series that does not have the potential to pay Coupons also includes interest incurred by the Investor under an Investment Loan used to acquire those Units (subsection 110-25(4)).

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- (l) Any capital gain realised by the Investor as a result of the satisfaction of the Investor's rights in respect of their Units will be treated as a discount capital gain pursuant to section 115-5 where the Investor is an individual, a complying superannuation entity or a trust and has held the Units for at least 12 months.
- (m) The commercial debt forgiveness rules in Division 245 will not apply to reduce the tax attributes of an Investor as a result of the debt forgiveness that occurs when the limited recourse provisions of the Investment Loan come into effect if at Maturity insufficient Sale Monies are raised from the Agency Sale Option in order for the Investor to fully repay the loan.
- (n) The Units under the DPA are not 'securities', as defined in subsection 159GP(1) of the ITAA 1936.
- (o) Any loan establishment fee incurred by the Investor is deductible under section 25-25 and will not be denied under section 51AAA of the ITAA 1936 where the Investment Loan is used to acquire Units in a Series that has the potential to pay Coupons.
- (p) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA of the ITAA 1936 will not apply to the Investor in respect of an investment in the Units offered under the DPA.

Assumptions

10. This Ruling is made on the basis of the following necessary assumptions:
- (a) The Investor is an Australian resident for tax purposes.
 - (b) The Investor is not a trader in financial instruments or securities and is not treated for tax purposes as trading in the Units or the Delivery Assets, carrying on a business of investing in the Units or the Delivery Assets, or holding the Units or the Delivery Assets as trading stock or as revenue assets.
 - (c) The Investor has not made an election under section 230-455 to have Division 230 apply to their financial arrangements and is
 - (i) an individual
 - (ii) 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
 - (iii) an ADI, a securitisation vehicle or other financial sector entity with an aggregated turnover of less than \$20 million, or
 - (iv) 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.
 - (d) Units that pay a Fixed Coupon only and do not offer the possibility of any other type of Coupon will not be made available under a Series where those Units are acquired with an Investment Loan.

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- (e) The dominant purpose of the Investor in entering into the scheme is to derive assessable income from the scheme that exceeds the deductible expenditure that they incur in respect of it.
- (f) The Investor will, at the time of entering into the scheme, have a purpose of staying in the scheme until it is completed, and will not terminate their involvement in the scheme prior to the Maturity Date.
- (g) An Investor that is a complying superannuation fund is not prevented from investing in the scheme by any particular terms of its trust deed, and is not in breach of any stated investment strategy.
- (h) The scheme will be executed in the manner described in the Scheme section of this Ruling and the scheme documentation mentioned in paragraph 11 of this Ruling.
- (i) All dealings between the Investor, the Issuer and the Arranger will be at arm's length.

Scheme

11. The scheme is identified and described in the following:

- application for a product ruling as constituted by documents and information received on 12 January 2024, 19 February 2024 and 23 February 2024
- Master IM, dated 1 September 2023, and
- draft Anadara Term Sheet Information Memorandum (Term Sheet IM) dated 12 February 2023.

Note: Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

12. For the purposes of describing the scheme, 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.

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

Overview of scheme

14. The details of the DPA are summarised as follows:

- (a) An offer to participate in the DPA will be made by the Arranger to prospective investors in various Series by way of the Master IM and a Term Sheet IM. Each Series will be governed by the general terms in the Master IM and specific terms in the Term Sheet IM which are applicable to that Series (the Terms).
- (b) On acceptance of an Investor's Application and receipt by the Issuer of the amounts payable by the Investor by the Offer Closing Date, the Issuer will issue Units on the Issue Date to the Investor. Upon the issue of those Units, the Investor will receive a beneficial interest in a Portion of the Delivery Assets (Beneficial Interest). That Beneficial Interest may not be dealt with separately in any way from the Investor's interest in the Units.

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- (c) The Minimum Investment Amount required to be invested by each Investor will be set out in the relevant Term Sheet IM for a Series. The Issue Price of a Unit will be \$1.00 per Unit.
- (d) One or more Coupons may be payable in respect of issued Units, as specified in the relevant Term Sheet IM. The Coupons comprise of
 - (i) Fixed Coupons (if any), where the return and payment frequency is fixed
 - (ii) Performance Coupons (if any), including any Final Coupon, conditional upon the positive performance of the Reference Asset, and
 - (iii) Conditional Coupons (if any), paid only if certain pre-defined conditions are met.
- (e) Investors that are not complying superannuation funds must, when offered under the relevant Term Sheet IM for a Series, enter into a limited recourse Investment Loan from the Issuer, as Lender, to finance up to 100% of the Investment Amount payable to the Issuer.
- (f) The Investment Loan
 - (i) bears interest (the Prepaid Interest) at a rate fixed for the Investment Term, payable on the Prepaid Interest Dates (the first of which will be on the Application Payment Date) and generally payable in advance for a period which may or may not exceed 12 months, as specified in the relevant Term Sheet IM, and
 - (ii) is repayable on or before the Maturity Date, unless either Early Maturity or an Investor Insolvency occurs and subject to application of the limited recourse feature whereby the Lender's recourse against the Investor for repayment is limited to the Investor's interest in the Units.
- (g) Where the Investor repays the Investment Loan in full on or before the Maturity Date and does not validly elect to use the Agency Sale Option under a Notice of Maturity at least 10 Business Days before the Maturity Date, physical delivery of the Delivery Parcel will occur. Where this occurs, the Issuer will purchase the Delivery Parcel, register the shares in an issuer sponsored holding account in the name of the Investor, and deliver the Delivery Parcel to the Investor on the Settlement Date or as soon as possible thereafter.
- (h) Where the Investor validly elects to use the Agency Sale Option under a Notice of Maturity at least 10 Business Days before the Maturity Date, or does not repay their Investment Loan in full by the Maturity Date and is deemed to have elected to use the Agency Sale Option, the Issuer will accept physical delivery of the Delivery Parcel on behalf of the Investor and sell the Delivery Parcel for and on behalf of the Investor on or as soon as reasonably practicable after the Settlement Date. The Sale Monies will be applied to repay the Loan Amount (where not repaid) or paid to the Investor (where the Loan Amount is repaid by the Maturity Date).
- (i) Upon delivery of the Delivery Parcel as outlined in subparagraph 14(g) of this Ruling or the payment or application of the Sale Monies in accordance with subparagraph 14(h) of this Ruling, the Issuer's obligations to the

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Investor under the Terms will be satisfied and discharged. The delivery of the Delivery Parcel or the payment or application of the Sale Monies, as applicable, on the Settlement Date or as soon as possible thereafter may, as specified in the relevant Term Sheet IM, be wholly in satisfaction or discharge of the Investor's right to receive either a Performance Coupon (as a Final Coupon) or the Final Value.

- (j) The features of each Series described in the relevant Term Sheet IM will include
 - (i) the Reference Asset
 - (ii) the Investment Term
 - (iii) the interest rate applicable to the Investment Loan (if any)
 - (iv) the Interest Payment Dates (if any)
 - (v) applicable Fees
 - (vi) calculation of any Final Coupon, Performance Coupons, Conditional Coupons or Fixed Coupons
 - (vii) the Coupon Payment Dates (if any)
 - (viii) key risks to Investors
 - (ix) the Delivery Asset (being a share in a company listed on the Australian Securities Exchange)
 - (x) the Final Value of a Unit on the Maturity Date (if any), and
 - (xi) the Minimum Investment Amount.
- (k) The Reference Asset to which the Units will provide exposure over the Investment Term will be any one or more of the following
 - (i) an equities index
 - (ii) any exchange traded equity or fund, or
 - (iii) any basket of equities or exchange traded funds.

Commissioner of Taxation

22 May 2024

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Appendix – Explanation

❶ *This Explanation 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.*

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Coupons assessable as ordinary income under section 6-5

15. Section 6-5 includes income according to ordinary concepts (ordinary income) in assessable income. Whether or not a particular amount is income according to ordinary concepts depends on the nature and character of the receipt in the hands of the taxpayer.

16. Any Coupons paid or credited by the Issuer on the Units held by the Investor are ordinary income of the Investor and included as assessable income under section 6-5 in the income year in which they are paid or credited to the Investor.

Deductibility of interest under section 8-1

17. A loss or outgoing is deductible under section 8-1 if its essential character is that of expenditure that has a sufficient connection with the operations or activities which more directly gain or produce a taxpayer's assessable income, provided that the expenditure is not of a capital, private or domestic nature.

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18. Where there is a possibility that Coupons may be received, interest incurred by the Investor on the Investment Loan in respect of the Units has a sufficient connection with the gaining of assessable income (being the Coupons) to be deductible under section 8-1 and is deductible in full on the basis that the Investor's purpose of investing in the Units is to derive a return from these assessable amounts in excess of their expenditure.

19. For Units in a Series that do not offer the possibility of paying Coupons, interest incurred on the Investment Loan is not deductible under section 8-1. The interest incurred by the Investor under these circumstances does not have a sufficient connection with the gaining of assessable income to be deductible under section 8-1 and is not deductible on the basis that the Investor's purpose of investing in the Units is to derive a return of a capital nature.

Section 51AAA of the ITAA 1936

20. Section 51AAA of the ITAA 1936 denies a deduction under section 8-1 where the deduction would only be allowable because a net capital gain has been included in a taxpayer's assessable income. As interest incurred by the Investor on the Investment Loan under a Series which offers the possibility of Coupons being paid 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 under those circumstances.

Section 82KL of the ITAA 1936

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

Subdivision H of Division 3 of Part III of the ITAA 1936

22. 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 the carrying on of a business, whether the Investor is a small or medium business entity, whether the Investor is an individual and whether the Investor is not an individual and incurs the expenditure otherwise than in carrying on a business. This Subdivision does not apply to 'excluded expenditure', which is defined in subsection 82KZL(1) of the ITAA 1936 to include amounts of less than \$1,000 or amounts of expenditure that are of a capital nature.

Subdivision 328-C – small business entities for the purposes of Subdivision H of the ITAA 1936

23. 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

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- 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 2 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 of the ITAA 1936

24. The Prepaid Interest charged on the Investment Loan that is deductible under section 8-1 may or may not be 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 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 and not to the period of the loan.

Sections 82KZME and 82KZMF of the ITAA 1936 – prepaid expenditure and ‘tax shelter’ style arrangements

25. The rules in sections 82KZME and 82KZMF of the ITAA 1936 apply, subject to the exceptions in section 82KZME of the ITAA 1936, where expenditure is incurred in relation to a ‘tax shelter’ style arrangement for the doing of a thing under an agreement that is not to be wholly done within the expenditure year, and where certain requirements for that agreement are met.

26. 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 participation in the DPA, including the financing.

27. Section 82KZMF of the ITAA 1936 will have operation and apportion over the relevant period each Prepaid Interest amount incurred by the Investor which is allowable as a deduction under section 8-1 where:

- the Prepaid Interest is not excluded expenditure and is for a period extending beyond the end of the income year in which it is incurred, and
- the Investor’s allowable deductions that are attributable to the DPA for the income year in which the Prepaid Interest is incurred exceeds their assessable income that is attributable to the DPA for that same year.

28. Each of the other requirements for the agreement under subsection 82KZME(3) of the ITAA 1936 are met and none of the other exceptions contained in subsections 82KZME(5), (8) or (9) of the ITAA 1936 apply to exclude Prepaid Interest incurred from the operation of section 82KZMF of the ITAA 1936.

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29. For each of the years of income during which part of the Prepaid Interest Period falls, the Investor can deduct an amount using the following formula set out in paragraph 82KZMF(1)(b) of the ITAA 1936:

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

30. Where sections 82KZME and 82KZMF of the ITAA 1936 do not apply to set the amount and timing of deductions for Prepaid Interest amounts incurred by the Investor, the deductibility of the Prepaid Interest must be considered under the prepayment rules contained in paragraphs 31 to 35 of this Ruling.

Sections 82KZMA and 82KZMD of the ITAA 1936 – prepaid non-business expenditure incurred by non-individual and non-small and medium business entities

31. Sections 82KZMA and 82KZMD of the ITAA 1936 set the amount and timing of deductions for expenditure that an Investor (other than a small business entity, or an entity covered by subsection 82KZMA(2A) of the ITAA 1936², for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure) that is not an individual and does not incur the expenditure in carrying on a business. 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.

32. For these Investors, the amount of Prepaid Interest incurred under the Investment Loan which is allowable as a deduction under section 8-1 will be apportioned over the relevant interest payment period.

Section 82KZM of the ITAA 1936 – prepaid expenditure incurred by certain small and medium business entities and individuals incurring non-business expenditure

33. Subject to paragraph 34 of this Ruling, section 82KZM of the ITAA 1936 operates to spread over more than one income year a deduction which, apart from that section, would be allowable under section 8-1 for the year of income in which the prepaid expenditure is incurred under an agreement by a taxpayer that is either:

- a small business entity, or an entity covered by subsection 82KZM(1A) of the ITAA 1936³, for the year of income that has not chosen to apply section 82KZMD of the ITAA 1936 to the expenditure, or
- an individual that has not incurred the expenditure in carrying on a business.

34. Section 82KZM of the ITAA 1936 applies if:

- the prepaid expenditure is not excluded expenditure, and

² An entity is covered by subsection 82KZMA(2A) of the ITAA 1936 for the expenditure year if the entity is not a small business entity for that year but would be a small business entity for that year if each reference to \$10 million in section 328-110 (as noted in paragraph 23 of this Ruling) were instead a reference to \$50 million.

³ An entity is covered by subsection 82KZM(1A) of the ITAA 1936 for the expenditure year if the entity is not a small business entity for that year but would be a small business entity for that year if each reference in section 328-110 to \$10 million (as noted in paragraph 23 of this Ruling) were instead a reference to \$50 million.

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- 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.

35. Where the Prepaid Interest is not excluded expenditure and the eligible service period in relation to the deductible Prepaid Interest under the Investment Loan is more than 12 months, section 82KZM of the ITAA 1936 will have application to Investors referred to in paragraph 33 of this Ruling.

Application of the capital gains tax provisions to Units under the Anadara Deferred Purchase Agreement

36. Under subsection 108-5(1) a CGT asset is any kind of property or a legal or equitable right that is not property. The rights of an Investor under the Terms to the DPA are legally enforceable rights and therefore, in their totality, a CGT asset according to the definition in subsection 108-5(1).

37. Where the Delivery Parcel is delivered to the Investor or the Sale Monies under the Agency Sale Option are applied on behalf of, or paid to, the Investor either in respect of the Investor's entitlement to the Final Value or a Performance Coupon (as a Final Coupon), as specified in the relevant Term Sheet IM, the Investor's ownership of the contractual rights under the DPA is discharged or satisfied. This discharge or satisfaction of the contractual rights gives rise to CGT event C2 (paragraph 104-25(1)(b)).

38. The Investor will make a capital gain from this CGT event if the capital proceeds from the ending of the Investor's ownership of the asset are more than the asset's cost base or, alternatively, a capital loss from this CGT event if those capital proceeds are less than the asset's reduced cost base (subsection 104-25(3)).

39. The Investor's capital proceeds from the CGT event will be equal to the Sale Monies applied against the Investment Loan on behalf of the Investor or received by the Investor under the Agency Sale Option, or the market value of the Delivery Parcel received on (or shortly after) the Settlement Date, as applicable (section 116-20).

40. The cost base or reduced cost base of the Investor's rights under the DPA includes, as its first element, the Investment Amount (subsections 110-25(2) and 110-55(2)). The cost base of the Investor's rights under the DPA will also include, as its third element, non-deductible interest incurred by the Investor (where their Investment Loan is used to acquire Units in a Series that does not have the potential to pay Coupons; subsection 110-25(4)). Such interest is not included in the reduced cost base of the Investor's rights under the DPA (subsections 110-55(2) and (3)).

41. Where part or all of the capital proceeds from the CGT event also represents Coupons received by an Investor and are included in assessable income under section 6-5 (about ordinary income), subsection 118-20(1) will apply to reduce any capital made by the Investor to nil if it does not exceed the amount included as assessable income. Therefore, for Units in a Series that only pays a Performance Coupon (as a Final Coupon) at (or shortly after) Maturity and does not pay a Final Value, the Investor will not make any capital gain or capital loss from CGT event C2 pursuant to the application of subsection 118-20(1) to the capital proceeds that are attributed to that Coupon that is included as ordinary income.

42. 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 as a result of the satisfaction of the Investor's rights under the DPA will be treated as a discount capital gain

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where the Investor is an individual, a complying superannuation entity, or a trust and has held those rights under the DPA for at least 12 months (excluding the days of acquisition and disposal).

Division 245 – commercial debt forgiveness

43. The Investment Loan will be treated as a ‘commercial debt’ under section 245-10.

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

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

46. To calculate the net forgiven amount of a debt, it is first necessary to calculate the ‘gross forgiven amount’ of a debt. In the Investor’s circumstances, Division 245 will have no practical effect as there will be no gross forgiven amount in respect of the Investment Loan. The gross forgiven amount is equal to the value of the debt when it is forgiven (worked out under section 245-60) less the amount (if any) that is offset against the value of the debt when it is forgiven (worked out under section 245-65).

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

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

Subsection 159GP(1) of the ITAA 1936 – a Unit is not a ‘security’

49. Under subsection 159GP(1) of the ITAA 1936, a ‘security’ means:

- (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
- (b) a deposit with a bank or other financial institution;
- (c) a secured or unsecured loan; or
- (d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

50. The Units issued under the DPA are not considered to have sufficient debt like obligations to be a contract to which paragraph (d) of the definition of security in subsection 159GP(1) of the ITAA 1936 applies, nor do they fall within paragraphs (a), (b) or (c) of that definition. Therefore, such Units do not meet the definition of security under subsection 159GP(1) of the ITAA 1936.

Section 25-25 – loan establishment fee

51. A loan establishment fee, if applicable, incurred by an Investor upon successful application for an Investment Loan will be an allowable deduction pursuant to section 25-25 where it is a cost of borrowing money used for the purpose of producing

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assessable income and section 51AAA of the ITAA 1936 does not apply to deny the deduction under section 25-25 because the deduction would only be allowable as a consequence of a net capital gain having been included in the Investor's assessable income. Where the Investment Loan is used to acquire Units in a Series that does not have the potential to pay Coupons, the loan establishment fee is not deductible under section 51AAA of the ITAA 1936.

52. Where deductible, the loan establishment fee will be deductible on a straight-line basis over the period of the shorter of the term of the Investment Loan or 5 years.

Status: **not legally binding**

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