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Income Tax Treatment of Instalment Warrants Proposals Paper

The Taxation Institute of Australia (**Taxation Institute**) thanks you for the opportunity to make submissions in relation to the proposals outlined in The Treasury Consultation Paper "Income Tax Treatment of Instalment Warrants" dated March 2010 (the **Consultation Paper**).

Legislative references in this submission are to provisions of the *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997* (together, the **Act**) unless otherwise indicated.

1. Summary of Submissions

The Taxation Institute makes the following submissions:

- 1.1 That consideration be given as to the correctness of the Australian Taxation Office's (**ATO**) conclusion that the investor in an instalment warrant arrangement is not "absolutely entitled" to the underlying asset *as against the trustee*. As a result, it may be decided that:
 - (a) no legislative amendments are necessary in order to achieve the desired taxation treatment; or
 - (b) the desired tax treatment may be accomplished through legislative clarification of interpretative issues (eg regarding "absolute entitlement").
- 1.2 If submission 1.1 is not accepted, that the proposed "look-through" treatment be applied not only to a non-recourse loan applied to acquire a single exchange traded security, but to:
 - (a) all arrangements involving the transfer of legal title to an underlying asset to a trustee, custodian or nominee for the purposes of providing security to a creditor; and

- (b) all assets stipulated in the "capital protected borrowing" provisions in Division 247.

1.3 If submission 1.1 is not accepted, that the proposed transitional provisions adequately address the position of taxpayers with a 4 year review period and those taxpayers who entered into arrangements prior to the start date of the amending legislation.

2. **Absolute Entitlement**

2.1 **Submission**

That consideration be given, and counsel's advice sought, in relation to the ATO conclusion that an investor in an instalment warrant arrangement is not "absolutely entitled" to the underlying asset as against the security trustee.

If such further consideration of the law supports the conclusion that an investor in an instalment warrant arrangement (or any other arrangement involving the transfer of the legal title to an asset for the purposes of providing security) **is** absolutely entitled to the underlying asset as against the security trustee, it becomes unnecessary to legislate a "look-through" approach to instalments warrants.

In these circumstances, there would be no need for legislative clarification, provided that the ATO is willing to apply this interpretation of the law.

An alternative legislative approach could be to clarify the meaning of the phrases "absolute entitlement" and "vested and indefeasible" in the legislation. In particular, legislative clarification could be enacted that certain features commonly associated with instalment warrants do not prevent an investor from being "absolutely entitled" to, or to having a "vested and indefeasible interest" in, the underlying asset.

If this approach is adopted, two of the key issues that require clarification are that:

- (a) where an investor contracts with a third party (other than the trustee/nominee of the underlying asset) not to exercise the investor's rights as against the trustee/nominee to call for the assets, this does not *of itself* prevent the investor from having a "vested and indefeasible" interest in the underlying asset, or being "absolutely entitled" to the asset;
- (b) a mortgage or other security granted over underlying assets, whether by the trustee/nominee or the investor, to secure payment of a debt should not *of itself* prevent the investor from having a "vested and indefeasible" interest in the underlying asset, or being "absolutely entitled" to the asset.

The advantage of this approach is that it provides taxpayers with wider certainty by applying a "principle approach", rather a piecemeal solution targeted only at instalment warrants. Pursuant to this approach, the particular rights and obligations as between the investor, the legal owner of the underlying asset (eg trustee of a security trust or a nominee) and the financier will be determinative of the tax treatment, rather than the particular type of arrangement.

2.2 **Summary of law**

The rule established in *Saunders v Vautier* (1841) 49 ER 282, is that a beneficiary will be absolutely entitled to an asset as against the trustee if they have a vested and indefeasible interest in the asset, being the ability to call for the asset to be transferred to them or to be transferred at their direction. This rule was subsequently confirmed in *Tomlinson v Glyns Executor and Trustee Co* (1969) 45 TC 600.

In *Kafataris & Anor v Deputy Federal Commissioner of Taxation* [2008] FCA 1454, Lindgren J stated at paragraph 61 of his judgement that:

"...the expression "absolutely entitled to the asset as against the trustee" in subs (5) of section 104-55 and section 104-60 of the Act is intended to describe a situation in which the beneficiary of a trust has a vested, indefeasible and absolute entitlement in trust property and **is entitled to require the trustee to deal with the trust property as the beneficiary directs**".

The Explanatory Memorandum (**EM**) to the *Taxation Laws Amendment Bill (No.8) 1999* states the following with respect to the meaning of "absolute entitlement":

"A person is absolutely entitled to trust property if he or she is able to direct the trustee how to deal with trust property and to give the trustee a good receipt for anything with which the trustee has parted; that is, the beneficiary must be sui juris, and have a vested, indefeasible, and absolute interest in the trust property so that the trustee may be compelled to convey the trust property to the beneficiary if so requested. In such a case, there is an identity of interest between the trust and the beneficiary; indeed the trustee is effectively an agent of the beneficiary....".

In an instalment warrant arrangement, an investor has the right as against the Security Trustee to call for the underlying asset from the Security Trust, however, they have contractually agreed with the financier not to exercise this right prior to their repayment of the loan. Therefore at law (and notwithstanding the investor's contractual arrangement), the investor is absolutely entitled to the underlying asset *as against the Security Trustee*. The same analysis can apply to other arrangements whereby an underlying asset is transferred for the purposes of providing security where the only restriction preventing the investor from calling for the asset is a contractual obligation to a third party.

3. **Definition of "Instalment Warrants" and "Traditional Instalment Warrants"**

3.1 **Submission:**

In the event Submission 1.1 is not accepted, that the proposed "look-through" treatment be applied to:

- (a) all arrangements involving the transfer of legal title to an underlying asset to a trustee, custodian or nominee for the purposes of providing security to a creditor; and
- (b) all assets stipulated in the "capital protected borrowing" provisions in Division 247.

3.2 **Proposed definition of "Traditional Instalment Warrants"**

The "traditional instalment warrants" to which the proposed amendments are currently intended to apply involve:

- (a) a non-recourse borrowing by the investor (and no other guarantee to the lender);
- (b) the acquisition of a single exchange traded security in a company, trust or stapled entity;
- (c) a trust to hold the security primarily to provide security to the lender; and

- (d) the investor having the benefits of ownership of the underlying asset.

The Consultation Paper's only description of a "non-traditional instalment warrant" is an instalment warrant arrangement with the features above, with the exception that the underlying asset is real property.

The result of defining, in a prescriptive manner, the features of a limited range of financial products to which the proposed legislative change applies, is that the proposal fails to address a significant proportion of the secured borrowing market.

In particular, the proposal fails to address five very common arrangements:

- (a) instalment warrant arrangements involving an underlying security that is not listed on an exchange;
- (b) instalment warrant arrangements involving an underlying asset that is a basket of securities rather than a single security;
- (c) arrangements that involve the provision of credit but no "borrowing" (instalment receipt arrangements);
- (d) full recourse borrowing arrangements where the borrower/investor is required to utilise a security trust or other nominee arrangement; and
- (e) arrangements pursuant to which an associate of the borrower is required to provide a guarantee.

Each of these arrangements is discussed in more detail below.

In our view, there is nothing unique to "traditional instalment warrants" (as defined in the Consultation Paper) that would justify singling out these arrangements for the "look-through" approach, and as such there is no policy reason for treating any of the other arrangements identified above as giving rise to different taxation outcomes. To do so would distort retail investor decision-making in relation to appropriate investments and product issuer decision-making in relation to offerings of investment products.

In member discussions with the ATO and Treasury following release of the Consultation Paper, each of the ATO and Treasury confirmed that the fact the Consultation Paper does not address such arrangements is not a result of any policy of the ATO to treat the arrangements differently. Rather the failure to address these arrangements results from a lack of awareness as to the full extent of the market.

In summary, the proposed application of the provisions to "traditional instalment warrants" results in the proposed provisions having a scope that is so narrow that it results in divergent and inequitable treatment between arrangements that are, in all material respects, identical.

To address this issue, it is submitted that the proposed provisions apply to:

- (f) the following arrangements:
 - (i) any arrangement that involves the transfer of legal title to an underlying asset to a trustee/nominee for the purposes of providing security for payment of a debt owed to a third party creditor; or

- (ii) alternatively, if (sub para i) is considered too broad, then any capital protected borrowing as defined in Division 247 whereby legal title to an underlying asset to a trustee/nominee for the purposes of providing security for payment of a debt owed to a third party creditor;
- (g) underlying assets that are:
 - (i) shares, units or stapled securities that are listed for quotation on the official list of an approved stock exchange;
 - (ii) shares in a widely held company (as defined);
 - (iii) units in widely held unit trust as defined in section 272-105 in Schedule 2F (or its replacement provision in the 1997 act);
 - (iv) stapled securities where the relevant company is a widely held company and the trust is a widely held unit trust; and
 - (v) a basket of securities referred to in paragraphs (a) – (d) above (ie not only single securities).

From a drafting perspective, we note that the capital protected borrowing rules in Division 247 already provide an appropriate framework for defining the relevant underlying assets. The Taxation Institute considers that the range of assets to which the provisions should apply should reflect all those assets that are "protected things" under that Division.

3.3 Instalment Warrants over unlisted securities

Limited recourse loan and security trustee arrangements have traditionally been used to acquire not only listed securities, but unlisted securities such as units in unlisted registered managed investment schemes (**MIS**).

This arrangement is identical to the "traditional instalment warrant" arrangement outlined above, save for the fact that the regulated MIS is not listed or traded on any exchange. The only difference is the degree of liquidity of the underlying asset. There is no apparent policy reason for treating the arrangements as giving rise to divergent tax outcomes.

Further, the fact that instalment warrant arrangements have been and are used in this manner has been legislatively acknowledged in the enactment of Division 247 of the Act.

Following the decision of the Full Federal Court in *Commissioner of Taxation v Firth* 120 FCR 450 (**Firth's case**) the Treasurer announced by Media Release on 16 April 2003 that the law with respect to capital protected borrowings would be amended and that that amendment would apply to "capital protected products that are used to acquire listed shares, units and stapled securities".

However, the enacted provisions apply more broadly, to limited recourse loans to acquire:

- (a) shares, units or stapled securities that are listed for quotation on the official list of an approved stock exchange;
- (b) shares in a widely held company (as defined);

- (c) units in widely held unit trust as defined in section 272-105 in Schedule 2F; and
- (d) stapled securities where any relevant company is a widely held company and any relevant trust is a widely held unit trust.

The amendments made to introduce Division 247 clearly recognise that capital protected borrowing arrangements, including instalment warrants, can be used to acquire unlisted interests, and are intended to apply to those arrangements in the same manner as capital protected borrowings applied to acquired listed securities.

In our view, the policy reasons for applying the capital protected borrowing provisions to listed and unlisted securities apply equally in the context of applying a "look-through" approach to certain secured borrowings. Given this, it is submitted that the same types of underlying assets should be subject of the proposed new provisions.

Furthermore, it would be incongruous and inequitable for Parliament to treat geared investors in unlisted securities in an identical manner to those in listed securities for the purpose of denying the investor a deduction for interest expenses, but then to treat the two differently for the purposes of taxation of the investor's income and gains. Further, it appears inequitable to treat a superannuation trustee investor in an instalment warrant arrangement over unlisted MIS units in a different manner to an individual investor in the same product.

Finally, excluding instalment warrants over unlisted securities is likely to reduce unlisted entities' access to retail investor capital, in favour of listed entities. This would distort investment decisions made by retail investors.

3.4 **Example 1 - Listed v unlisted underlying assets**

That there should be no difference in taxation treatment for such arrangements as demonstrated by the following example:

(a) **Investment 1: Instalment Warrant over units in Streettracks STW (a listed MIS tracking the ASX 200)**

The proposed amendments outlined in the Consultation Paper should apply as, pursuant to the arrangement:

- (i) the Investor has taken a limited recourse loan to acquire STW units;
- (ii) STW units are held by a Security Trustee until the time of repayment of the Loan (and the Security Trustee has granted a mortgage over the units to secure the borrowing); and
- (iii) the investor receives all of the benefits of ownership of the STW units including all income distributions and any capital gains.

As a result, the arrangement would qualify for the proposed "look-through" treatment.

(b) **Investment 2: Instalment Warrant over units in an unlisted registered MIS that tracks the ASX 200 (MIS Units)**

The arrangement is identical to the instalment warrant referred to above in that, pursuant to the arrangement:

- (i) the Investor has taken a limited recourse loan to acquire the MIS Units;
- (ii) the MIS Units are held by a Security Trustee until the time of repayment of the Loan (and the Security Trustee has granted a mortgage over the units to secure the borrowing); and
- (iii) the investor receives all of the benefits of ownership of the MIS Units including all income distributions and any capital gains.

However, the arrangement would not qualify for the proposed "look-through" treatment due only to the fact that the MIS Units are not listed.

(c) **Differences in tax treatment**

If the proposed change is enacted in its current terms:

- (i) **tax returns** - the Security Trustee for Investment 1 will lodge no tax returns; the Security Trustee for Investment 2 will be required to lodge a tax return for every separate Investor, and possibly every separate Instalment for every separate Investor;
- (ii) **franking credits** - an Investor in Investment 1 would likely receive the benefits of distributed franking credits; an Investor in Investment 2 may be denied franking credits ;
- (iii) **prepaid interest** - a non-business individual Investor in Investment 1 will be entitled to deduct prepaid interest at the time of payment; it is not clear that the same Investor would be entitled to prepayment deductions under Investment 2;
- (iv) **CGT on acquisition** - a shareholder or rollover applicant Investor in Investment 1 will have no CGT consequences on application; the same Investor in Investment 2 may realise a capital gain or loss at that time;
- (v) **CGT on repayment** - an Investor in Investment 1 will have no CGT consequences on repayment of the Loan; an Investor in Investment 2 will realise a capital gain or loss at that time; and
- (vi) **CGT discount** - an Investor in Investment 1 will have the benefit of discount CGT treatment for the entire period of holding the underlying asset (assuming this exceeds 12 months); an Investor in Investment 2 will not, unless ultimate disposal occurs more than 12 months following repayment of the Loan.

These differences are set out in greater detail in the Annexure.

3.5 **Instalment Warrants over baskets of securities**

Basket instalments have also been issued, including with the benefit of ATO Product Rulings (eg see PR 2008/71).

Instalment warrants over baskets of securities allow investors to diversify their investment risk within a single product.

That such arrangements exist and are in contemplation of the legislature is evident by the fact that these arrangements are explicitly addressed in the EM to the capital protected borrowing provisions (refer to EM Example 7.5).

Again, there is no policy justification for limiting "look-through" treatment to arrangements involving a "single exchange traded security" or for treating such arrangements differently from a basket of securities held by a security trustee on identical terms. This would cause a distortionary effect on the market, as it would prevent issuers from being able to offer investors the benefits of investment diversification within a single product.

3.6 Instalment Receipts

The proposal also fails to address another very common structure for the instalment purchase of securities, being an instalment receipt arrangement. This arrangement has been used by the Government itself in selling down its holdings in the Commonwealth Bank of Australia and Telstra, and was used most recently by the Government in the T3 offering.

An instalment receipt arrangement is economically equivalent to an instalment warrant arrangement, except that it utilises vendor financing rather than third party financing. Pursuant to an instalment receipt, such as T3, an investor acquires securities from a vendor with the purchase price paid in instalments. Upon payment of the initial instalment, the security is transferred to a security trustee to hold the instrument to secure payment of the final instalment of the purchase price to the vendor.

As with the arrangements referred to above, an instalment receipt would be treated as a capital protected borrowing arrangement to which Division 247 applies. This is on the basis that, although there is no loan or other borrowing, there is a provision of credit to the purchaser.

As above, we consider it incongruous and inequitable for an investor in an instalment receipt to be denied deductions on the same basis as an instalment warrant investor, but to be treated differently for the purposes of determining the taxation treatment of the investor's income and gains. This is particularly so when there is no policy justification for treating the economically identical arrangements in a different manner. Rather, the differential tax treatment will distort the market by providing a fiscal disincentive against the use of vendor financing, thereby restricting the market's access to a useful and efficient source of credit.

We further note that, if the Telstra T3 sell-down was undertaken today, the ATO would conclude that there would be a taxing event upon payment by the investor of the final instalment for the Telstra shares (ie prior to the investor's disposal of those shares). Such an offering would not meet the requirements for "look-through" treatment outlined in the Consultation Paper and we would expect that, as with all other rulings in respect of instalment warrants, instalment receipts and capital protected borrowings satisfying the provisions of section 67(4A) of the *Superannuation Industry (Supervision Act) 1993*, no ruling would be issued by the ATO in respect of the offering.

Finally we note that the comments above apply equally to superannuation trustee and non-superannuation trustee investors. That is, a superannuation trustee investor who acquires an instalment receipt, whether this is a T3 instalment receipt¹ or an

¹ Leaving aside for these purposes the Telstra T3 Class Ruling CR 2007/51.

instalment receipt of another issuer, would be subject to tax on any unrealised gain arising at the time of payment of the final instalment in respect of that arrangement.

3.7 **Example 2 - Instalment Warrants v Instalment Receipts**

That there should be no difference in taxation treatment for such arrangements is demonstrated by the following example:

(a) **Investment 1: Instalment Warrant over BHP Shares**

The proposed amendments outlined in the Consultation Paper should apply as, pursuant to the arrangement:

- (i) the Investor has a limited recourse loan to fund a portion of the purchase price of the BHP shares;
- (ii) the BHP shares are held by a Security Trustee until the time of repayment of the Loan (and the Security Trustee has granted a mortgage over the BHP shares to secure the borrowing); and
- (iii) the investor receives all of the benefits of ownership of the BHP shares including all income distributions and any capital gains.

As a result, the arrangement would qualify for the proposed "look-through" treatment.

(b) **Investment 2: Instalment Receipt over BHP Shares**

The arrangement is economically equivalent to the instalment warrant referred to above in that, pursuant to the arrangement:

- (i) the Investor has an outstanding debt to the vendor for a portion of the purchase price of the BHP shares;
- (ii) the BHP shares are held by a Security Trustee until the time of payment of the outstanding purchase price (and the Security Trustee has granted a mortgage over the shares to secure the liability); and
- (iii) the investor receives all of the benefits of ownership of the BHP shares including all income distributions and any capital gains.

However, the arrangement would not qualify for the proposed "look-through" treatment due only to the fact that the BHP shares are not acquired with a loan but rather are acquired with vendor financing.

(c) **Differences in tax treatment**

If the proposed change is enacted in its current terms:

- (i) **tax returns** - the Security Trustee should not be required to lodge a tax return under either of Investment 1 or 2; however, if the BHP shares were instead unlisted shares, the Security Trustee would be required to lodge a tax return for every separate Investor, and possibly every separate instalment receipt for every separate Investor;

- (ii) **franking credits** - an Investor in Investment 1 would likely receive the benefits of distributed franking credits; an Investor in Investment 2 may be denied franked credits;
- (iii) **CGT on repayment** - an Investor in Investment 1 will have no CGT consequences on repayment of the Loan; an Investor in Investment 2 will realise a capital gain or loss at the time of payment of the outstanding instalment of the purchase price; and
- (iv) **CGT discount** - an Investor in Investment 1 will have the benefit of discount CGT treatment for the entire period of holding the underlying asset (assuming this exceeds 12 months); an Investor in Investment 2 will not unless ultimate disposal occurs more than 12 months following payment of the final instalment of the purchase price.

These differences are set out in greater detail in the Annexure.

3.8 **Guaranteed Arrangements**

We also provide the following comments on whether the new amendments permit the giving of the guarantee by the Custodian. Also we provide comments on whether, in the situation where the Super Trustee is a company, the directors (or a sole director) of the Super Trustee may give a personal guarantee to the lender.

Whether additional security is permitted

The new s.67 (4A) of the SIS Act requires, in paragraphs (d) and (e), that the lender's rights "against the [trustee of the fund]" be limited to rights relating to the asset acquired with the use of the borrowed monies. It does not preclude the lender from having rights against another person nor does it circumscribe any such rights. It follows, in our view, the amendments do not prohibit the giving of a guarantee by the Custodian or by the directors (or a sole director) of a corporate Super Trustee.

Guarantor's right of indemnity against Super Trustee

The following observations apply where a guarantee, of the kind permitted by the new amendments, is given. They apply to the guarantee given by the Custodian. One of the ordinary legal incidents of a guarantee is that, if the guarantor pays the debt, or is called on by the lender to pay the debt, he has a right of indemnity against the principal debtor. The right of indemnity may, however, be expressly excluded by agreement between the guarantor and principal debtor.

If the Custodian's right of indemnity against the Super Trustee is not excluded by agreement between the Custodian and the Super Trustee, the Super Trustee will be liable to indemnify the Custodian in the event that the Custodian is called on by the lender to pay the debt. It is not necessary that the Custodian pay the debt before claiming an indemnity. The Custodian would be entitled, pursuant to the right of indemnity, to require the Super Trustee to pay the debt to the lender in order to give effect to the Custodian's right of indemnity.

If the Custodian and the Super Trustee execute a deed which has the effect of excluding the Custodian's right of indemnity then if the Custodian pays the lender, then the Super Trustee will not be liable to the Custodian. This is consistent with both the letter and spirit of the new provisions.

Guarantor's right of subrogation

Another legal incident of a guarantee is that, if the guarantor pays the principal debt, he stands in the shoes of the creditor and is able to exercise all the rights of the creditor including enforcing any security that the creditor holds in relation to the principal debt. The right of subrogation may, however, be expressly excluded by agreement between the guarantor and the creditor.

If the Custodian pays the lender the Custodian will be able to enforce the loan agreement and the mortgage, according to their terms, pursuant to its right of subrogation as if the Custodian was the lender. A guarantor's rights of subrogation, however, go no higher than the rights which the lender had. Since, under the loan and the mortgage, the lender had no recourse against the Super Trustee personally, neither will the Custodian in so far as the Custodian wishes to avail itself of a guarantor's rights of subrogation. The other assets of the fund will therefore not be at risk.

Therefore, the existence of a guarantor's right of subrogation to the lender's security does not conflict with the letter or spirit of the new s.67 (4A).

We therefore submit that there is no legislative or other changes required in relation to the giving of guarantees by the Custodian or directors (or a sole director) of a Corporate Trustee.

4. Timing and transitional issues

4.1 Submission

That the amendments:

- (a) take effect from the 2005/2006 income year; and
- (b) address the position of holders who, prior to the start income year, entered into arrangements the subject of the proposed change

4.2 Start income year

The announcement made on 10 March 2010 by Assistant Treasurer, Senator Nick Sherry, states that the proposed amendment will apply for assessments for the 2007/2008 and later income years.

This aligns with taxpayers having a 2 year review period for assessments.

However, some investors in the arrangements covered by the amendments may have a 4 year review period for amendment of assessments. The start date for the legislation should be set such that it is not possible for the ATO to amend assessments of any taxpayer who has entered into an arrangement of the type covered by the legislation.

4.3 Holders who have acquired in years prior to start year

That is, the ATO, after having issued around 50 Product Rulings on Instalment Warrants, should not be permitted to do a "U-turn" resulting in amendment of taxpayer's assessments retrospectively.

The proposed amendments are intended to apply to income derived and CGT events occurring in the 2007/2008 income years and later. They will, for arrangements to which they apply, treat the investor in the arrangement as the holder of the underlying asset for taxation purposes.

The legislation should clarify how investors who entered into an arrangement prior to the legislation start date should be treated. In particular, the legislation should clarify that:

- (a) an investor who entered an arrangement as a cash applicant prior to the start date is treated as the owner of the asset at all times;
- (b) an investor who entered an arrangement as a shareholder or rollover applicant is treated as having a cost base for CGT purposes equal to their original cost base in the asset; and
- (c) the commencement of the legislation does not have any impact on an investor who was the holder of an arrangement at the start date (ie, the start date of the legislation does not itself trigger a CGT event).

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If you require any further information or assistance in respect of our submission, please contact David Williams on 02 9958 3 or the Taxation Institute's Tax Counsel, Angie Ananda, on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink that reads "D Williams". The signature is written in a cursive, slightly slanted style.

David Williams
President

ANNEXURE

Event / Issue	Scenario 1: Instalment Warrant over STW Units/BHP shares (listed) <i>(applying proposed amendments)</i>	Scenario 2: Instalment Warrant over <u>unlisted</u> MIS Units	Scenario 3: Instalment <u>Receipt</u> over BHP Shares
Security Trust Tax Return required	No.	<p>Yes.</p> <p><i>One tax return for each separate investor and potentially for each separate instalment warrant (eg. for 2 million instalment warrants each over 1 MIS Unit = 2 million trust tax returns).</i></p> <p><i>(Refer PS LA 2000/2)</i></p>	<p>No - if BHP Shares are listed</p> <p>Yes - if BHP Shares are not listed</p> <p><i>One tax return for each separate investor and potentially for each separate instalment warrant (eg. for 2 million instalment warrants each over 1 MIS Unit = 2 million trust tax returns).</i></p> <p><i>(Refer PS LA 2000/2)</i></p>
Income from Investment	Single application of Division 6 Trust rules: Included in assessable income of Investor under section 97.	<p>Double application of Division 6 Trust rules:</p> <ul style="list-style-type: none"> - Included in net income of the Security Trust under section 97; - Investor will include income of security trust in assessable income under section 97. 	<p>Double application of Division 6 Trust rules:</p> <ul style="list-style-type: none"> - Included in net income of the Security Trust under section 97; - Investor will include income of security trust in assessable income under section 97.
Distribution of franking credits	The Investor would be treated as owning the share/units and, assuming the Investor is otherwise a qualified person, the Investor would be entitled to a tax offset for its share of any franking credits attached to the dividend/distribution.	<p>The Security Trustee is treated as the owner of the MIS Units having an interest in the shares held by the MIS determined on the basis of a holding of an interest in a widely held trust. If the Security Trustee is a qualified person, the franking credits would be included in the net income of the Security Trust.</p> <p>The Investor will have an "interest in an interest" in the relevant shares. That interest is held through a closely held trust, and the</p>	<p>The Security Trustee is treated as the owner of the shares. If the Security Trustee is a qualified person, the franking credits would be included in the net income of the Security Trust.</p> <p>The Investor will have an interest in the relevant shares. That interest is held through a closely held trust, and the Investor will be entitled to franking credits only to the extent that the Investor's interest in the Security</p>

Event / Issue	Scenario 1: Instalment Warrant over STW Units/BHP shares (listed) <i>(applying proposed amendments)</i>	Scenario 2: Instalment Warrant over <u>unlisted</u> MIS Units	Scenario 3: Instalment <u>Receipt</u> over BHP Shares
		<p>Investor will be entitled to franking credits only to the extent that the Investor's interest in the Security Trust is vested and indefeasible.</p> <p><i>On the ATO's view that an Investor does not have an indefeasible interest in the MIS Units, the Investor will be denied access to franking credits.</i></p>	<p>Trust is vested and indefeasible.</p> <p><i>On the ATO's view that an Investor does not have an indefeasible interest in the shares, the Investor will be denied access to franking credits.</i></p>
Interest on Funding/credit	<p>Deductible subject to Div 247.</p> <p>Timing: Prepaid interest allowable at time of prepayment for non-business individual taxpayers (Exception 1 in section 82KZME satisfied).</p>	<p>Deductible subject to Div 247.</p> <p><i>Timing: Prepayment deductions may not be available, as the Investor may be viewed as not having incurred interest on money borrowed to acquire the Units (refer s82KZME(5)).</i></p>	<p>Deductible subject to Div 247.</p> <p>Timing: Prepayment deductions not available (refer s82KZME(5)).</p>
Acquisition by Cash Applicant	<p>Investor acquires shares/units at time of acquisition of Instalment Warrant.</p>	<p>Security Trustee acquires MIS Units at the time of acquisition of Instalment Warrant.</p> <p>Investor acquires CGT asset, being interest in Security Trust at time of acquisition of Instalment Warrant.</p>	<p>Security Trustee acquires shares at the time of acquisition of Instalment Receipt.</p> <p>Investor acquires CGT asset, being interest in Security Trust at time of acquisition of Instalment Receipt.</p>
Acquisition by Shareholder or Rollover Applicant	<p>No CGT consequences for Investor.</p>	<p><i>Unless section 104-10(7) applies (exception where disposal is to provide a security), a CGT Event A1 occurs for the Investor, triggering a capital gain or loss equal to the difference between the market value of the MIS Units at the time of acquisition of the Instalment Warrant and the Investor's cost base in the Units.</i></p> <p>Security Trustee acquires MIS Units at the</p>	<p>N/A</p>

Event / Issue	Scenario 1: Instalment Warrant over STW Units/BHP shares (listed) <i>(applying proposed amendments)</i>	Scenario 2: Instalment Warrant over <u>unlisted</u> MIS Units	Scenario 3: Instalment <u>Receipt</u> over BHP Shares
		<p>time of acquisition of Instalment Warrant.</p> <p>Investor acquires a new CGT asset, being interest in Security Trust at time of acquisition of Instalment Warrant.</p>	
<p>Repayment of the Loan/payment of final instalment on purchase price</p>	<p>No CGT consequences for Investor.</p>	<p><i>A CGT Event E5 will occur for the Security Trustee and the Investor. Each will derive a capital gain or loss.</i></p> <p><i>The Security Trustee's capital gain or loss will be equal to the difference between the market value of the MIS Units at the time of repayment and its cost base in those Units.</i></p> <p><i>The Investor's capital gain or loss will be equal to the difference between the market value of the asset at the time of repayment and its cost base in its interest in the Security trust .</i></p> <p><i>Any capital gain derived by the Security Trustee will also be included in the assessable income of the Investor under section 97.</i></p> <p><i>Will section 118-20 apply to prevent double taxation? Even if it does, a taxing event has still occurred.</i></p>	<p><i>A CGT Event E5 will occur for the Security Trustee and the Investor. Each will derive a capital gain or loss.</i></p> <p><i>The Security Trustee's capital gain or loss will be equal to the difference between the market value of the shares at the time of the payment of the final instalment and its cost base in those shares.</i></p> <p><i>The Investor's capital gain or loss will be equal to the difference between the market value of the asset at the time of the payment of the final instalment and its cost base in its interest in the Security trust .</i></p> <p><i>Any capital gain derived by the Security Trustee will also be included in the assessable income of the Investor under section 97.</i></p> <p><i>Will section 118-20 apply to prevent double taxation? Even if it does, a taxing event has still occurred.</i></p>
<p>Disposal of Instalment Warrant/Receipt</p>	<p>A CGT Event A1 occurs for the Investor in relation to the STW units/shares. The Investor will realise a capital gain or loss equal to the difference between the disposal</p>	<p>A CGT Event A1 occurs for the Security Trustee in relation to the MIS Units. The Security Trustee will realise a capital gain or loss equal to the difference between the</p>	<p>A CGT Event A1 occurs for the Security Trustee in relation to the shares. The Security Trustee will realise a capital gain or loss equal to the difference between the</p>

Event / Issue	Scenario 1: Instalment Warrant over STW Units/BHP shares (listed) <i>(applying proposed amendments)</i>	Scenario 2: Instalment Warrant over <u>unlisted</u> MIS Units	Scenario 3: Instalment <u>Receipt</u> over BHP Shares
	<p>proceeds of the units/shares and the Investor's cost base or reduced cost base.</p> <p>A CGT Event C2 will occur for the Investor in relation to the expiry of any notional put option arising under Division 247. This will give rise to a capital loss equal to the Investor's cost base in that asset.</p>	<p>disposal proceeds of the MIS Units and the Security Trustee's cost base or reduced cost base.</p> <p><i>A CGT Event E5 will also occur for the Investor, with a capital gain or loss arising equal to the difference between the disposal proceeds received by the Security Trustee in respect of the MIS Units and the Investor's cost base or reduced cost base in its interest in the Security Trust.</i></p> <p><i>Any capital gain derived by the Security Trustee will also be included in the assessable income of the Investor under section 97.</i></p> <p><i>Will section 118-20 apply to prevent any double taxation?</i></p> <p>A CGT Event C2 will occur for the Investor in relation to the expiry of any notional put option arising under Division 247. This will give rise to a capital loss equal to the Investor's cost base in that asset.</p>	<p>disposal proceeds of the shares and the Security Trustee's cost base or reduced cost base.</p> <p><i>A CGT Event E5 will also occur for the Investor, with a capital gain or loss arising equal to the difference between the disposal proceeds received by the Security Trustee in respect of the shares and the Investor's cost base or reduced cost base in its interest in the Security Trust.</i></p> <p><i>Any capital gain derived by the Security Trustee will also be included in the assessable income of the Investor under section 97.</i></p> <p><i>Will section 118-20 apply to prevent any double taxation?</i></p> <p>A CGT Event C2 will occur for the Investor in relation to the expiry of any notional put option arising under Division 247. This will give rise to a capital loss equal to the Investor's cost base in that asset.</p>
<p>Reliance on limited recourse provision (market value of underlying asset is less than</p>	<p>A CGT Event A1 occurs for the Investor in relation to the units/shares. The Investor will realise a capital gain or loss equal to the difference between the disposal proceeds of the units/shares (being the protected value) and the Investor's cost base or reduced cost</p>	<p>A CGT Event A1 occurs for the Security Trustee in relation to the MIS Units. The Security Trustee will realise a capital gain or loss equal to the difference between the disposal proceeds of the MIS Units <i>(in this case the market value of the MIS Units)</i> and the Security Trustee's cost base or</p>	<p>A CGT Event A1 occurs for the Security Trustee in relation to the shares. The Security Trustee will realise a capital gain or loss equal to the difference between the disposal proceeds of the shares <i>(in this case the market value)</i> and the Security Trustee's</p>

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acquisition cost)	<p>base.</p> <p>The cost of the notional or actual put option will be included in the cost base and reduced cost base of the units/shares for these purposes under Division 134</p>	<p>reduced cost base.</p> <p><i>Where the Investor has only a notional put option:</i></p> <p>This is not clear, but we assume that a CGT Event A1 occurs for the Investor in relation to its interest in the Security Trust. The Investor will realise a capital gain or loss equal to the difference between the disposal proceeds of the interest in the Security Trust (being the protected value) and the Investor's cost base or reduced cost base.</p> <p>The cost of the notional put option will be included in the cost base and reduced cost base of the interest in the Security Trust for these purposes under Division 134.</p> <p><i>Where the Investor has an actual put option over the MIS Units:</i></p> <p>This is less clear. A CGT Event E5 will also occur for the Investor, with a capital gain or loss arising equal to the difference between the disposal proceeds received by the Security Trustee in respect of the MIS Units and the Investor's cost base or reduced cost base in its interest in the Security Trust.</p> <p><i>A CGT Event C2 will occur in relation to the Put Option - if this explicitly relates to the MIS Units, Division 134 does not provide for it to be included in the cost base of the Investor's interest.</i></p>	<p>cost base or reduced cost base.</p> <p><i>Where the Investor has only a notional put option</i></p> <p>This is not clear, but we assume that a CGT Event A1 occurs for the Investor in relation to its interest in the Security Trust. The Investor will realise a capital gain or loss equal to the difference between the disposal proceeds of the interest in the Security Trust (being the protected value) and the Investor's cost base or reduced cost base.</p> <p>The cost of the notional put option will be included in the cost base and reduced cost base of the interest in the Security Trust for these purposes under Division 134.</p> <p><i>Where the Investor has an actual put option over the Shares</i></p> <p>This is less clear. A CGT Event E5 will also occur for the Investor, with a capital gain or loss arising equal to the difference between the disposal proceeds received by the Security Trustee in respect of the shares and the Investor's cost base or reduced cost base in its interest in the Security Trust.</p> <p><i>A CGT Event C2 will occur in relation to the Put Option - if this explicitly relates to the shares, Div 134 does not provide for it to be included in the cost base of the Investor's interest.</i></p>

Event / Issue	Scenario 1: Instalment Warrant over STW Units/BHP shares (listed) <i>(applying proposed amendments)</i>	Scenario 2: Instalment Warrant over <u>unlisted</u> MIS Units	Scenario 3: Instalment <u>Receipt</u> over BHP Shares
Disposal following completion	Discount CGT is available provided disposal is 12 months following acquisition of Instalment Warrant.	<i>Discount CGT is not available in respect of gain realised from time of Loan repayment to disposal unless that period exceeds 12 months.</i>	<i>Discount CGT is not available in respect of gain realised from time of payment of final purchase price instalment to disposal unless that period exceeds 12 months.</i>