



Australian Government
Australian Taxation Office

How are capital protected products and borrowings treated?

The way a capital protected product or borrowing is treated for tax purposes depends on:

- whether or not a product ruling applies to it
- the date the arrangement was entered into or extended, and
- whether it provides capital protection by way of a limited recourse loan only, or another method.

Which treatment applies to your product?

Step 1 - Does a product ruling cover the arrangement?

Yes go to [Capital protected products or borrowings covered by product rulings](#)

No go to **Step 2**

Step 2 - Was the capital protected product or borrowing entered into or extended before 9.30am on 16 April 2003?

Yes go to [Products entered into before 9.30am on 16 April 2003](#)

No go to **Step 3**

Step 3 - Was the capital protected product or borrowing entered into or extended on or after 9.30am on 16 April 2003 but before 1 July 2007?

Yes go to [Products entered into or extended on or after 9.30am on 16 April 2003 but before 1 July 2007](#)

No go to **Step 4**

Step 4 - Was the capital protected product or borrowing entered into on or after 1 July 2007?

Yes go to [Products entered into on or after 1 July 2007](#)

What capital protected products or borrowings are covered by product rulings?

You can search our [Legal database](#) for a product ruling on your particular capital protected product or borrowing.

The issue and withdrawal dates of the rulings govern the way they are applied to your arrangement. Some rulings have been withdrawn but are still relevant to arrangements that were entered into before they were withdrawn.

How are products which are covered by product rulings treated?

If you have invested in a product that is covered by a product ruling, you should refer to that ruling to determine the tax treatment that applies. Most rulings cover products with limited recourse loans and a separately identifiable 'put option' – see [What are capital protected products and borrowings?](#)

The fact that you hold a product covered by a product ruling does not conclusively determine that the ruling applies to you. Read the ruling to confirm that:

- the product you hold and the circumstances in which you hold it are in fact covered by the ruling, and
- the date you entered into the arrangement makes the ruling relevant to your circumstances.

Capital protected products or borrowings not covered by product rulings

The treatment of capital protected products or borrowings that are not covered by a product ruling depend on whether you entered into or extended the arrangement before 9.30am on 16 April 2003 or between 9.30am on 16 April 2003 and 30 June 2007, and arrangements entered into after 1 July 2007.

Products entered into before 9.30am on 16 April 2003

Based on the decision in the *Firth v. Federal Commissioner of Taxation*, interest will be fully deductible on products entered into before 9.30am on 16 April 2003 where the capital protection is only provided by way of a limited recourse loan facility and the loan does not separately identify or attach value to the capital protection component.

[ATO Interpretive Decision ATO ID 2003/674](#) deals with the treatment of capital protected products without a separately identifiable 'put option' entered into before 16 April 2003.

For products that use other methods of capital protection, the tax implications will depend on the specific terms and conditions of the capital protected product. Taxpayers seeking information on capital protected products acquired before 9.30am on 16 April 2003, that are not covered by a product ruling and provide capital protection other than by way of limited recourse loans, can request a private ruling to gain certainty on the issue.

Products entered into or extended on or after 9.30am on 16 April 2003 but before 1 July 2007

Part of the interest cost is attributed to the capital protection feature of the loan and is not deductible.

The following rules apply to capital protected products – such as instalment warrants traded on the Australian Securities Exchange (ASX) – that contain an explicit put option which gives the investor/borrower the right to 'put' or sell the underlying share, unit or stapled security ('underlying security') back to the lender for the higher of the market value or the amount outstanding under the loan.

- In the case of a purchase in the primary market (prior to listing on the ASX), the cost of the capital protection component is the amount that is paid for the put option.
- In the case of a purchase on the secondary market (once listed on the ASX):
 - if the market value of the underlying security at the time of purchase is greater than the loan amount, the amount attributed to the cost of the capital protection component is the price of the instalment warrant plus the loan amount less the sum of the market value of the underlying security and the interest prepaid on the newly acquired loan, or
 - if the market value of the underlying security at the time of purchase is equal to or less than the loan amount, the amount attributed to the cost of the capital protection component is the price of the instalment warrant less the interest prepaid on the newly acquired loan.

Other capital protected products

- The cost of the capital protection component is the greater of:
 - the difference between the total amount, ignoring amounts that are not in substance for capital protection or interest, incurred by borrower in respect of the borrowing and the amount determined by applying the Reserve Bank of Australia's indicator rate for personal unsecured loans - fixed or variable rate, whichever is applicable to the same amount of borrowing, **and**
 - the amount determined by reference to the following specified percentage amounts of the expense on a capital protected product:
 - 40% for a product with a term of one year or shorter
 - 27.5% for a product with a term longer than one year but not longer than two years
 - 20% for a product with a term longer than two years but not longer than three years
 - 17.5% for a product with a term longer than three years but not longer than four years, and
 - 15% for a product with a term longer than four years.

Products entered into on or after 1 July 2007

For capital protected products entered into on or after 1 July 2007, the amount that is reasonably attributable to capital protection is calculated using three steps.

- The first step is to calculate the total costs incurred by the borrower under or in respect of the capital protected product for the income year, ignoring amounts that are not in substance for capital protection or interest.

- The second step is to apply the Reserve Bank's indicator variable interest rate for personal unsecured loans to the same amount of borrowing.



Note: It has been proposed that the benchmark rate will be changed to the standard housing loan rate – see [Capital protected products - change to benchmark interest rate](#)

- If the borrowing is at a fixed rate you would apply the indicator variable interest rate at the time the first of the amounts in Step 1 was incurred. If the borrowing is at a variable rate, you would apply the average of the indicator rates during the term of the borrowing.
- Where the amount under Step 1 exceeds the amount under Step 2, the excess is attributed to the capital protection for the income year. If the underlying securities you purchased under the capital protected borrowing are held on capital account, the excess would be a capital cost and would not deductible.

What to read/do next

[What are capital protected products and borrowings?](#)

[Capital protected products – change to benchmark interest rate](#)

For help applying this information to your own situation, phone us on **13 28 61**.

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