more give, less take

NAB Super Lever – Taxation considerations

Important notice

This document does not contain advice. The tax implications of investing in the NAB Super Lever product can be complex and are subject to ongoing change. Investors should seek professional tax advice in relation to their particular circumstances.

This document provides a summary of some taxation matters which may be relevant to investors in the NAB Super Lever product. This is not a comprehensive taxation guide and the relevant taxation issues for investors are not limited to those outlined in this guide. It is strongly recommended that investors seek comprehensive taxation advice in relation to investment in the NAB Super Lever product. Taxation implications could be significant if they are not properly taken into account.

Terms in this document have the meanings given in the NAB Super Lever Facility Terms.

Taxation laws are subject to constant change. This summary is based on the taxation laws current as at 25th May 2012. Unless otherwise indicated, statutory references are to the Income Tax Assessment Act 1936 ("1936 Act") and/or the Income Tax Assessment Act 1997 ("1997 Act").

1. CGT and absolute entitlement

The financed investments are held by the investment trustee under the security arrangements while the loan is outstanding.

Technically, when the loan is repaid and the investment trustee transfers the assets to the investor, tax may be payable on any gain on the investments during the time they have been held by the trustee, unless the investor is absolutely entitled to the assets as against the trustee under the trust arrangement.

Technically, due to the operation of trust law principles, the investor may not be absolutely entitled, and so there may be a technical tax exposure on transfer.

This is an unintended result and the Government has announced that the law will change.

On 10 March 2010 the then Minister for Financial services, Superannuation and Corporate law, Chris Bowen, announced that the Government proposes to amend the law so that a superannuation trustee who enters into a limited recourse borrowing arrangement to purchase an asset will be treated as the owner of the asset for income tax purposes. This would remove the taxing point on transfer of the asset from the investment trustee.

The proposed changes are intended to take effect from the 2007-8 income year, but they have not yet been introduced into Parliament.

The ATO has announced that it will accept returns as lodged until the proposed laws are introduced and will not take compliance action prior to that time.

The ATO has confirmed by letter that the NAB Super Lever is a limited recourse borrowing arrangement covered by these administrative arrangements.

2. Income from the financed investments

Broadly, all of the distributions in respect of the financed investments will flow through the investment trust to be taxed in the hands of the investor. Specific issues are outlined below. The exact consequences depend on whether the financed investments comprise shares in a company or units in a trust.

Dividends

Where the financed investments are shares, distributions will be in the form of a dividend or other distributions in respect of the shares.

Where a dividend or other distribution is franked, the investor should include in assessable income the amount of the dividend and the franking credit attaching to the dividend. An investor should generally be allowed a tax offset equal to the franking credit. This offset should reduce the tax liability of the investor to the extent that the investor has such a liability. Complying superannuation entities in receipt of franking tax offsets in excess of their tax liability should be entitled to a refund of those excess tax offsets.

However, the entitlement to franking credits is subject to legislative restrictions, in particular the satisfaction of the "qualified person" or holding period rule. Investors may be denied the franking credits in respect of distributions received where the investor has not held their interest in the underlying securities "at risk" for a continuous period of 45 days (or 90 days if the shares are preference shares) over the prescribed period (ignoring the day of acquisition and disposal). When determining the number of days in the holding period in which an investor has held their shares "at risk", the days on which the entity has materially diminished risks of loss or opportunities for gain in respect of the shares are excluded. An investor will have materially diminished risks of loss or opportunities for gain in respect of shares if the investor's net position (determined using the financial concept, delta) in relation to the shares has less than 30% of those risks or opportunities.

Investors should seek their own taxation advice in relation to the potential application of those provisions to their own particular circumstances from year to year.

Distributions from public trading trusts or corporate unit trusts

Where the financed investments are units in a trust that is a public trading trust or a corporate unit trust for the purposes of the tax law, distributions should be treated for tax purposes as if they were dividends or other distributions in respect of shares (that is, as described under the heading "Dividends" immediately above).

Distributions from trusts that are not public trading trusts or corporate unit trusts

Where the financed investments are units in a trust other than a public trading trust or a corporate unit trust, the tax treatment of the distribution of income or capital will depend on the character of the amount in the trustee's hands before it was distributed to the investor.

If the distribution represents an amount that was dividend income in the trustee's hands, the tax consequences for the investor of receiving the distribution should be the same as if the distribution were a dividend (see under the heading "Dividends" above). However, the application of the "qualified person" rules is even more complicated than where the financed investments are shares.

If the distribution represents an amount that was a capital gain in the trustee's hands, broadly, the distribution should be treated as a capital gain for the investor. The capital gain may be offset against revenue or capital losses of the investor. Where the CGT discount has been applied by the trustee to the capital gain before distribution, the investor will be required to gross up the discounted capital gain for the purposes of offsetting any capital losses, before applying the CGT discount itself.

If the distribution represents an amount that was not included in the taxable income of the trust (for example, an amount that was capital in the trustee's hands or that represents tax deductions available to the trust and which is typically referred to as a "tax deferred distribution"), the distribution will reduce the cost base of the investor's units in the trust. However, once the cost base has been reduced to zero, any excess distribution is assessable in full as a capital gain (but may be eligible for the CGT discount – discussed below.

3. Deductibility of interest

The availability of a deduction for interest on the loan depends on two factors – the purpose of the borrowing (relevant for the general deduction rules in section 8-1 of the 1997 Act) and the operation of Division 247 of the 1997 Act (which might operate to partially limit deductions).

Generally, to the extent that an investor uses the loan to acquire the financed investments for the purpose of producing assessable income,a deduction should be available under section 8-1 of the 1997 Act. The amount of interest which is deductible should be calculated having regard to Division 247 of the 1997 Act.

The purpose for which the loan is entered into by an investor can only be conclusively determined in light of all of the evidence as to that investor's individual facts and circumstances. Further, a change in an investor's purpose or use of the loan could result in a loss of interest deductions.

If Division 247 of the 1997 Act applies to partially limit the deductions in respect of interest on the loan, the non-deductible interest will be dealt with under the capital gains tax regime, Investors should obtain independent taxation advice in relation to the application of Division 247.

Timing of deductions

If interest is prepaid, deductions may not be available in the year in which the interest is paid, but may instead be spread over the relevant interest period.

Investors should obtain independent legal and taxation advice in relation to the timing of any deduction for Interest which takes into account the relevant investor's individual facts and circumstances.

Deduction for other borrowing costs

Other borrowing costs in relation to the NAB Super Lever should be deductible to the extent that the loan is applied to acquire the financed investments for the purpose of producing assessable income.

The amount of any deduction will likely be spread over the lesser of five years or the term of the loan.

However, if an investor incurs total borrowing expenses in any year of $100 or less, that investor may be able to deduct those costs in the year they are incurred.

4. Capital Gains Tax in relation to the financed investments

The CGT provisions apply if a "CGT event" occurs.

A capital gain will arise for a taxpayer if the "capital proceeds" received in respect of the occurrence of a relevant CGT event are greater than the "cost base" of the asset which is the subject of the CGT event. A capital loss will arise if the "reduced cost base" exceeds the "capital proceeds".

Investors may be eligible for the CGT discount (discussed further below) in respect of a capital gain made in relation to the financed investments.

Consistent with the administrative treatment of limited recourse borrowing arrangements by superannuation funds (referred to above), the comment in this part assumes that the ATO will accept tax returns lodged by investors on the basis that the investor is to be treated as holding the financed investments directly for CGT purposes.

CGT cost bases

For CGT purposes, the investor's cost base and reduced cost base in the financed investments should be equal to the amount paid to acquire those financed investments, together with any incidental costs.

Where the financed investment consists of a unit in a trust, the cost base of the unit may be reduced by "tax deferred distributions" received by the investor in respect of the unit (as also outlined above).

To the extent Division 247 applies (as mentioned above) this may also lead to capital gains tax outcomes for the investor. Investors should obtain independent taxation advice in relation to the application of Division 247.

Repayment of the loan – transfer of financed investments to investor

The repayment of the loan and the receipt of the financed investments from the investment trustee should have no CGT consequences for the investor in relation to those financed investments, as the investor should be treated as already owning the financed investments (as noted above).

Repayment of loan – sale of financed investments

If the investor repays the loan and sells the financed investments to fund the repayment, a disposal of the financed investments will occur for the investor. This may result in a capital gain or a capital loss to the investor with respect to the disposal of those financed investments.

If the limited recourse provisions of the loan are relied on, in calculating any capital loss on the disposal of the financed investments where the sale proceeds of the financed investments are less than the outstanding loan, it is likely that the Commissioner would seek to reduce the cost base of the financed investments by the amount of the shortfall. Investors should take independent taxation advice in relation to the sale of the financed investments.

Availability of the CGT discount

Investors making a capital gain in relation to the disposal of the financed investments may be eligible for the CGT discount.

To be entitled to the CGT discount, the investor must have held the relevant financed investments for at least 12 months before the CGT event happened (excluding the acquisition and disposal dates).

If the CGT discount concession applies, the investor must offset available capital losses against the capital gains then multiply the result by the relevant discount percentage to calculate to amount of their capital gain. The discount percentage is 33⅓% for complying superannuation funds.

5. Commercial Debt Forgiveness rules

If the full amount of the loan is not repaid due to its limited recourse nature, the amount not repaid may be regarded as a debt that has been forgiven for the purpose of the commercial debt forgiveness rules in Division 245 of the 1997 Act.

Where these rules apply the forgiven amount may reduce losses or deductible amounts otherwise available and may reduce the cost base of assets for CGT purposes.

There are special rules for valuing limited recourse debt which should result in there being no adverse consequences as a result of the limited recourse provisions of the loan being relied upon but investors should obtain their own professional advice in relation to the operation of the commercial debt forgiveness rules in relation to the loan.

6. Contributions tax

Contributions to superannuation funds are subject to tax and may, in certain cases, be subject to excess contributions tax.

The ATO has stated in a taxation ruling (TR 2010/1) that limited recourse borrowing arrangements such as the NAB Super Lever should not result in any "contribution" to the superannuation fund investor. The ruling also indicates that any payment made by a guarantor (of any amount by which the value of the financed investments falls short of the loan) should not be treated as a contribution to the superannuation fund when made pursuant to a limited recourse borrowing arrangement.

7. Taxation of Financial Arrangements (TOFA) Regime

The TOFA regime (contained in Division 230 of the 1997 Act) sets out the methods under which gains and losses from financial arrangements (as defined) will be brought to account for tax purposes.

One of the main features of the TOFA regime is to tax gains from financial arrangements on a revenue basis and in some cases on an accruals basis over the term of the arrangement.

The TOFA regime should not apply to investments in the NAB Super Lever product by a superannuation fund with assets of less than $100 million.

Further, the TOFA regime should not apply to tax gains on interests in managed investment schemes or shares in companies that are equity interests for tax purposes and so should not apply to tax gains on the financed investments acquired by the investors under the NAB Super Lever product.

Potential investors should seek their own taxation advice in relation to the application of the TOFA regime to their investment.

8. TFN

Investors will be requested to provide their TFN or ABN (if applicable) or claim an exemption in relation to the financed investments. Investors who do not provide their TFN or ABN or claim an exemption may have tax deducted from distributions or unfranked dividends at the highest marginal rate.

Consequently, whilst you are not required by law to provide your TFN and it's not an offence if you decide not to, if you do not provide it, your application will not be accepted.

9. GST

Australian GST applies at the rate of 10% to “taxable supplies”. For GST purposes, the following should not attract GST for NAB or the Investors:

- the provision, repayment and discharge of the loan;
- the payment of interest;
- the acquisition and disposal of the financed investments; and
- the payment of distributions in relation to the financed investments.

An investor may not be entitled to claim any “input tax credits”, including “reduced input tax credits”, for GST that it has paid to third party suppliers for services associated with the investment. The availability of credits will depend on whether the Investor is registered for GST, has acquired the service in the course of its enterprise, and whether the service qualifies for reduced input tax credits.

Individual investors should seek their own tax advice on their entitlement to claim input tax credits or reduced input credits.

10. Stamp Duty

There will not be any stamp duty in respect of the giving of security or the transfer of shares or units because:

- the security does not fall within the mortgage duty provisions in New South Wales (the only place still to impose mortgage duty which is abolished on 1 July 2012), and
- a transfer of unquoted shares in a company taken to be registered in South Australia or a foreign company having its registered office in South Australia will not be executed before 1 July 2012 (on which date such share duty will be abolished), and
- a transfer of unquoted shares in a company taken to be registered in New South Wales or a foreign company having a share register in New South Wales will not be executed before 1 July 2012 (on which date such share duty will be abolished), and
- a transfer of unquoted units on a New South Wales unit trust register will not be executed before 1 July 2012 (on which date such transfer duty will be abolished), and
- a transfer of unquoted units on a South Australian unit trust register will not be executed before 1 July 2012 (on which date such transfer duty will be abolished).

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