




ATO Interpretative Decision

ATO ID 2009/110

Income Tax

Self Managed Superannuation Funds: exchange traded options - tax treatment of premiums receivable

FOI status: may be released

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Issue

Where a self managed superannuation fund (SMSF) writes an exchange traded option (ETO) as part of a hedging strategy, are the premiums receivable from that activity included as assessable income under either section 6-5 or 15-15 of the *Income Tax Assessment Act 1997* (ITAA 1997)?

Decision

No. Where an SMSF writes an ETO as part of a hedging strategy, the premiums receivable from that activity are not included as assessable income under either section 6-5 or 15-15 of the ITAA 1997.

Facts

The taxpayer is a SMSF that is a complying superannuation fund.

The taxpayer holds an investment portfolio composed of ASX listed Australian equities.

The taxpayer writes an ETO over certain of these listed shares on the ASX Options Market as part of a hedging strategy.

Reasons for Decision

Paragraph 295-85(2)(a) of the ITAA 1997 provides that where a CGT event happens to a CGT asset of a complying superannuation fund, sections 6-5 and 15-15 of the ITAA 1997 will not apply and instead the CGT provisions will apply. An exception to this is contained in paragraph 295-85(3)(b) of the ITAA 1997 for CGT assets of the Fund that are

- (i) debenture stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
- (ii) a deposit with a bank, building society or other financial institution;
- (iii) a loan (secured or not); or
- (iv) some other contract under which an entity is liable to pay an amount (whether the liability is secured or not).

An option is a CGT asset as defined in subsection 108-5(1) of the ITAA 1997 and options are specifically cited as an example of a CGT asset (see Note 1 to subsection 108-5(2) of the ITAA 1997).

CGT Event D2 (granting of an option) will apply on the writing of an ETO by the Fund (section 104-40 of the ITAA 1997). Therefore, unless an ETO falls within one of the exceptions listed in paragraph 295-85(3)(b) of the ITAA 1997, the CGT provisions will be the only provisions to apply.

An ETO does not satisfy either subparagraph 295-85(3)(b)(ii) or 295-85(3)(b)(iii) of the ITAA 1997. Neither is an ETO one of the specifically listed instruments in subparagraph 295-85(3)(b)(i) of the ITAA 1997. In relation to the phrase 'or other security' in subparagraph 295-85(3)(b)(i), it is necessary to look at the history of section 295-85 of the ITAA 1997 to determine what instruments are included within the meaning of the phrase.

Section 295-85 of the ITAA 1997 represents a rewrite of section 304 of the *Income Tax Assessment Act 1936* (ITAA 1936). Subsection 303(1) of the ITAA 1936 set out the meaning of 'security' for the purposes of section 304 of the ITAA 1936. The Explanatory Memorandum to the Bill that introduced sections 303 and 304 of the ITAA 1936 provides that.

"security" ...for these purposes is defined in a similar way in Division 16E."

The subsection 303(1) of the ITAA 1936 definition of security is now contained in paragraph 295-85(3)(b) of the ITAA 1997.

Paragraph 3.1 of the Explanatory Memorandum to Tax Laws Amendment (Simplified Superannuation) Bill 2006 that introduced section 295-85 of the ITAA 1997, states that the rewritten provisions in Subdivision 295-B of the ITAA 1997 (including section 295-85) do not change the law as it operated under the previous ITAA 1936 provisions. Therefore, subsection 295-85(2) of the ITAA 1997 will apply CGT as the primary code of taxation for superannuation funds unless the ETO is a security as understood for the purposes of Division 16E of the ITAA 1936.

The Explanatory Memorandum accompanying Tax Laws Amendment Bill (No.2) 1986 which introduced Division 16E of the ITAA 1936 provided:

"security" has been defined very widely...so as to encompass as many financial transactions as possible **where there may be a deferral in the payment of income .**"

The Commissioner has previously stated in Taxation Ruling TR 96/14, that the Division 16E of the ITAA 1936 definition of 'security' contained in subsection 159GP(1) of the ITAA 1936 applies only to debt securities or contracts that create debt-like obligations.

Likewise, paragraph 295-85(3)(b) of the ITAA 1997 only encompasses debt securities or contracts that create debt-like obligations and therefore the phrase 'or other security' in subparagraph 295-85(3)(b)(i) of the ITAA 1997 covers only debt arrangements.

An ETO is a contract to buy or sell a financial product such as a share. The terms of an ETO are standardised and set by the ASX. ETOs are held until expiry or exercise, or are closed out by entering into an equal but opposite position. An ETO is not a debt instrument and therefore it will not fall within the meaning of the phrase 'or other security' for the purposes of subparagraph 295-85(3)(b)(i) of the ITAA 1997.

Subparagraph 295-85(3)(b)(iv) of the ITAA 1997 is broader than subparagraph 295-85(3)(b)(i) of the ITAA 1997. Like

paragraph 159GP(1)(d) of the ITAA 1936 it includes a broad range of contracts under which there is a liability to pay an amount.

However, TR 96/14 states that, in having regard to paragraphs (a), (b) and (c) of the definition of 'security', only those contracts that have 'debt like obligations' will usually fall under paragraph (d) of the definition of 'security'.

In accordance with TR 96/14, there are not sufficient debt-like obligations attaching to an ETO for it to fall under paragraph (d) of the definition of 'security'. Further, deferral of income is not a feature of an ETO arrangement.

Therefore, an ETO will not satisfy paragraph 295-85(3)(iv) of the ITAA 1997. Accordingly, an ETO is not an asset that falls within any of the exceptions in paragraph 295-85(3)(b) of the ITAA 1997.

Further an ETO is not trading stock (ATO ID 2004/526). Therefore, the exception for trading stock in subsection 295-85(4) of the ITAA 1997 will not apply.

As no exceptions in either subsection 295-85(3) or 295-85(4) of the ITAA 1997 apply to the Fund, the premiums receivable will not be assessable income of the Fund under section 6-5 of the ITAA 1997 but will be capital proceeds of the ETO under the CGT provisions.

CGT Event D2 will apply on the writing of an ETO by the Fund. The Fund as grantor of the option will make a capital gain (or loss) of the difference between the capital proceeds (that is, the premium receivable) and the cost of granting the option (for example, brokerage fees) at the time the option is granted (subsection 104-40(3) of the ITAA 1997).

Any capital gain arising under CGT event D2 is not eligible for the CGT discount (subsection 115-25(3) of the ITAA 1997).

Note 1: Where the fund has an open position at the end of the income year, the market value of that position is not deductible (ATO ID 2006/313)

Note 2: Any Initial or variation margin payments are not deductible (Taxation Determination TD 2006/25)

Note 3: Section 134-1 of the ITAA 1997 sets out the consequences if the option is exercised.

Date of decision: 28 September 2009

Year of income: Income year ending 30 June 2010

Legislative References:

Income Tax Assessment Act 1936

Division 16E

subsection 159GP(1)

paragraph 159GP(1)(d)

section 303

subsection 303(1)

section 304

Income Tax Assessment Act 1997

section 104-40

subsection 104-40(3)

subsection 108-5(1)

subsection 108-5(2)

subsection 115-25(3)

subsection 295-85(2)

subsection 295-85(3)

paragraph 295-85(3)(b)

subsection 295-85(4)

Related Public Rulings (including Determinations)

Taxation Ruling TR 96/14

Taxation Determination TD 2006/25

Related ATO Interpretative Decisions

ATO ID 2004/526

ATO ID 2006/313

Other References

Explanatory Memorandum to Tax Laws Amendment Bill (No. 2) 1986

Explanatory Memorandum to Tax Laws Amendment (Simplified Superannuation) Bill 2006

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