Guide to Taxation of Westpac Reset Instalments for the Financial Year ended 30 June 2010

Taxation changes for capital protected borrowings

On 16 April 2003, the Treasurer announced that the Federal Government would amend the tax law to change the tax treatment of capital protected products. Division 247 has now been inserted into the Tax Act to give effect to this announcement.

Division 247 applies to certain capital protected borrowings entered into on or after 1 July 2007. Transitional provisions apply to arrangements entered into between 16 April 2003 and 1 July 2007.

Division 247 operates to ensure that part of the expense on a capital protected product that is attributable to the capital protection feature is not deductible as interest or otherwise (but instead forms part of the capital gains tax cost base of the relevant asset). It effectively caps an investor's interest deductions by reference to a benchmark rate of interest. To the extent that the interest paid by the investor on a capital protected loan exceeds what would have been incurred if the benchmark rate had applied, the excess is not deductible.

From 1 July 2007 to before 7:30pm (AEST) on 13 may 2008, the benchmark interest rate was the Reserve Bank of Australia's variable indicator rate for personal unsecured loans. As part of the 2010-2011 Federal budget, the Treasurer announced that Division 247 would be amended to change the benchmark interest rate to the Reserve Bank's variable indicator rate for standard housing loans plus 100 basis points (1%). This announcement supersedes the announcement previously made by the government as part of the 2008-2009 Federal Budget. If enacted, these changes will apply to arrangements entered into after 7:30pm (AEST) on 13 May 2008. For arrangements entered into after 1 July 2007 and before 7:30pm (AEST) on 13 May 2008, the Reserve Bank's variable rate for personal unsecured loans will continue to be the applicable benchmark rate until 30 June 2013 or over the life of the product, which ever is the shorter.

Month	Personal unsecured rate	Housing loan rate (plus 100 basis points)
July 2007	12.60%	
August 2007	13.35%	
September 2007	13.35%	
October 2007	13.45%	
November 2007	13.80%	
December 2007	13.85%	
January 2008	13.90%	
February 2008	14.15%	
March 2008	14.55%	
April 2008	14.60%	
May 2008	14.65%	10.45%
June 2008	14.65%	10.45%
July 2008	14.90%	10.60%
August 2008	14.90%	10.60%
September 2008	14.85%	10.35%
October 2008	14.85%	9.35%
November 2008	14.60%	8.75%
December 2008	14.25%	7.85%
January 2009	14.10%	7.85%
February 2009	13.75%	6.85%
March 2009	13.50%	6.85%
April 2009	13.50%	6.75%

Month	Personal unsecured rate	Housing loan rate (plus 100 basis points)
May 2009	13.50%	6.75%
June 2009	13.50%	6.80%
July 2009	13.50%	6.80%
August 2009	13.50%	6.80%
September 2009	13.50%	6.80%
October 2009	13.75%	7.05%
November 2009	14.00%	7.30%
December 2009	14.25%	7.65%
January 2010	14.25%	7.65%
February 2010	14.25%	7.65%
March 2010	14.50%	7.90%
April 2010	14.75%	8.15%
May 2010	15.00%	8.40%
June 2010	15.00%	8.40%

1. Purchasing Westpac Reset Instalments during the 2009–2010 year

Your Westpac Tax Statement shows the amount of prepaid interest, borrowing fees* (if any) and Put Option Fees you are treated as having incurred as a result of the application of Division 247 at the time of purchasing your Westpac Reset Instalments. The following table sets out the income tax treatment of the amounts in your Westpac Tax Statement.

	Individuals/Small Business Entities	**Other Taxpayers**
Interest	Immediately deductible	Deduction is spread on a days basis to the next Reset Date
Put Option Fee	Non-deductible, but forms part of your Put Option cost base	
Borrowing Fees	Deductible over the lesser of 5 years or the period to the Completion Date	

*If you purchased your instalments via a Primary Market Application (Cash, Security Holder, or Rollover), you may have been charged a Borrowing Fee as indicated in the statement confirming your purchase.

The allocation of amounts incurred between interest and Put Option fees on the Tax Statement has been determined by the application of Division 247 as follows.

Primary market purchases

For primary market purchasers, Westpac Reset Instalments have a separately identifiable Put Option. This Put Option has a separate, identifiable price paid by the applicant upon the issue of the Westpac Instalments. This explicit cost of capital protection is non-deductible for investors.

Primary market acquisitions prior to the change of benchmark rate on 13 May 2008 are unlikely to have any additional amount of interest expense treated as being attributable to the cost of capital protection by Division 247 because the interest rate charged by Westpac was less than the relevant benchmark interest rate. Accordingly, Division 247 should have no practical application.

Primary market purchases after the reduction in the benchmark interest rate on 13 May 2008 are more likely to have an amount of prepaid interest attributed to the cost of the capital protection. Where this is the case, the interest deductions shown on the Tax Statement have been appropriately reduced and the cost base of the Put Option has been increased.

Secondary market purchases

If you acquire your Westpac Reset Instalment on the secondary market, there is no itemised cost associated with the acquisition of a Put Option. Although the amount paid by the investor to acquire their Westpac Instalments in the secondary market may reflect the fact that the Put Option Fee and the Prepaid Interest have been paid, the amount of the purchase price (if any) attributable to the cost of capital protection will be determined by the application of Division 247. Division 247 will treat any amount above what would have been paid if the benchmark interest rate had applied as attributable to the cost of capital protection. The amounts shown as deductible prepaid interest and Put Option cost in your Tax Statement have been determined by the application of Division 247.

The following table sets out how the interest and Put Option Cost amounts in your Westpac Tax Statement have been determined:

	Prepaid Interest	Put Option Cost
Primary market acquisitions	Is the lesser of: ▪ the actual amount of Prepaid Interest charged by Westpac; and ▪ the amount of interest that would have been incurred if the applicable benchmark interest rate had applied to the loan.	Is the sum of: ▪ the actual Put Option Fee charged by Westpac; and ▪ any excess of the actual Prepaid Interest over the benchmark interest amount that is treated as attributable to the Put Option by Division 247.
Secondary market applications	Is the lesser of: ▪ the actual acquisition price attributable to Prepaid Interest and the Put Option Cost; and ▪ the amount of interest that would have been incurred if the applicable benchmark interest rate had applied to the loan.	Is the excess (if any) of the actual acquisition price attributable to Prepaid Interest and the Put Option Cost over the amount of interest that would have been incurred if the benchmark interest rate had applied to the loan.

For self managed superannuation fund and company investors, the prepaid interest amounts determined in accordance with the above are then spread on a days basis to the next Reset Date.

Cost Base of Underlying Securities

Your cost base in the Underlying Securities depends on how you acquired your Westpac Instalments:

Cash Applicant	Securityholder Applicant	Rollover	Purchase on ASX
First Instalment + Completion Payment – (Interest Prepaid + Borrowing Fees + Put Option Fee).	Your cost base in the Underlying Securities prior to converting to Westpac Instalments.	Your cost base in the Underlying Securities from your previous series of Westpac Instalments.	Market Value (MV) of the Underlying Securities at the time of acquisition of your Westpac Instalment.

2. Annual Reset Date

On an annual Reset Date, the tax consequences depend upon your choice to make the Completion Payment, exercise your Put Option or continue to hold your Westpac Instalments (if available). If you continue to hold your Westpac Instalments, your Westpac Tax Statement shows the following amounts incurred on the Reset Date. Other scenarios are considered under the heading "Disposal" below.

Continue to hold Instalments

	Individual/Small Business Entities	Other Taxpayers
Interest	Interest prepaid on the Reset Date is immediately deductible.	Your deduction for the Prepaid Interest is spread over the next 12 months to the next Reset Date. Interest prepaid in the prior year but not deducted in that year is also deductible in the current year.
Put Option	The new Put Option Fee paid on the Reset Date is non-deductible but forms part of the new Put Option cost base. The existing Put Option lapses on the Reset Date and you will make a capital loss equal to your cost base in the old Put Option.	
Borrowing Fees	Your deduction for any Borrowing Fees you pay on the adjusted loan amount must be spread over the lesser of 5 years or the period from payment date to the Completion Date. You may also be entitled to a deduction for a portion of unclaimed Borrowing Fees you paid in prior years that were also required to be spread. These are set out on your Westpac Tax Statement.	

How interest deductions and Put Option costs are determined

On the reset date, Westpac separately charges investors an amount of prepaid interest and a Put Option Fee. Division 247 may operate to treat part of the prepaid interest amount as attributable to the cost of the capital protection. The following table sets out how the prepaid interest and Put Option cost on your Tax Statement have been determined.

	Prepaid Interest	**Put Option Costs**
Westpac Instalments acquired prior to 1 July 2007	The Prepaid Interest deduction is the amount actually incurred and is determined by reference to the interest rate charged by Westpac and the amount of the new Completion Payment.	The Put Option Fee is the actual cost of the new Put Option charged by Westpac on the Reset Date.
Westpac Instalments acquired from 1 July 2007 to 13 May 2008	The Prepaid Interest deduction is the amount actually incurred and is determined by reference to the interest rate charged by Westpac and the amount of the new Completion Payment. As the interest rate charged is less than the applicable benchmark interest rate, Division 247 has no practical application.	The Put Option Fee is the actual cost of the new Put Option charged by Westpac on the Reset Date. This is because no additional amount is treated as attributable to the cost of capital protection by Division 247.
Westpac Instalment acquired after 13 May 2008	Is the lesser of: ▪ the actual amount of Prepaid Interest charged by Westpac; and ▪ the amount of interest that would have been incurred if the benchmark interest rate had applied to the loan.	Is the sum of: ▪ the actual Put Option Fee paid; and ▪ any excess of the actual Prepaid Interest over the benchmark interest amount that is treated as attributable to the Put Option by Division 247.

On adjustment of the loan, investors may receive cash or there may be a purchase of additional instalments from the Rollover Cashback amount, or by default, Westpac may be required to sell a number of your Westpac Instalments to meet amounts owed. If you receive a Rollover Cashback Amount, you must use these funds for income producing purposes so as to not adversely impact the deductibility of interest on your Rollover Cashback Amount. In addition, to claim an upfront deduction for the interest prepaid in respect of Rollover Cashback Amount, that amount may need to be used to invest in certain types of investments (e.g. investing in listed shares). If there is a disposal of some of your Westpac Instalments you should refer to the heading "Disposal" below.

The receipt of a Rollover Cashback Amount, to the extent it represents the advance of an additional Loan Amount, should not be assessable to you.

If you pay an amount in relation to a Reset, to the extent that it represents the partial repayment of a loan, it is not deductible.

Investors who do not elect to receive a Rollover Cashback Amount may receive an additional allocation of Instalments as a result of the Reset. These investors will be treated as if they were a Cash Applicant in respect of the additional Instalments.

3. Disposal

Sell Instalment on the ASX

If you dispose of your Westpac Instalments on the ASX, you will receive a refund of prepaid interest as set out on your Westpac Tax Statement. The interest refund is assessable to you in the year you sell your Westpac Instalments. You must also determine the capital gains tax consequences for both the Underlying Securities and your Put Option.

Put Option:

	If MV of Underlying Securities	**Capital Proceeds on Put Option**
Capital proceeds	> Completion Payment.	Instalment Sale Price + Completion Payment – (MV of Underlying Securities + Interest Refund).
	< Completion Payment.	Instalment Sale Price – Interest Refund.
Cost base	See section 1 above.	
Capital gain	Where the capital proceeds > the cost base, you will make a capital gain, if not a capital loss may arise.	

Underlying Securities:

Capital proceeds	Instalment Sale Price + Completion Payment – Interest Refund – Proceeds allocated to the Put Option (see above).
Cost base	See section 1 above.
Capital gain	Where the capital proceeds > the cost base, you will make a capital gain; if not, a capital loss may arise.

If you are an individual or trustee, you should be entitled to the capital gains tax discount (50% for individuals and trusts, 33% for complying superannuation funds) if you have held your Westpac Instalments, (or in the case of a Securityholder Applicant, the underlying shares) for at least 12 months.

Exercise Put Option

If you disposed of your Westpac Instalments on a Reset Date or Revised Completion Payment Date, as applicable, by exercising your Put Option, Westpac would have sold the Underlying Securities in the Underlying Parcel and used the proceeds to pay off your Loan. You would have received the net proceeds (if any).

The disposal of the Underlying Securities would have been a CGT Event. You should therefore account for any capital gain or capital loss on the disposal of the beneficial ownership of the Underlying Securities in the income year ended 30 June 2010 (or the substituted accounting period applicable to you).

Upon exercising your Put Option, the cost base of the Put Option (which as detailed above would include, for example, the Put Option Fee and any interest on your Loan which was treated as non-deductible as a result of the application of Division 247) should be wholly attributable to the cost base of the Underlying Securities.

You may be eligible for the CGT discount for any capital gain made on disposal, if the Underlying Securities were acquired more than 12 months before the time of the CGT Event.

You will also be entitled to a deduction for the remaining balance of any undeducted Borrowing Fees (if any).

Underlying Securities:

Capital proceeds	Cash received (if any) + Completion Payment.
Cost base	The cost base of the Underlying Securities plus the cost base of your Put Option (see above).
Capital gain	Where the capital proceeds > the combined cost base you will make a capital gain; if not, a capital loss may arise.

Do nothing

If at the Revised Completion Date you did not give Westpac either a valid Completion Notice or Put Option Exercise Notice (ie, you did nothing), Westpac would have sold the Underlying Securities in the Underlying Parcel and used the proceeds to pay off your Loan. You would have received the net proceeds (if any).

The disposal of the Underlying Securities would have been a CGT Event. You should therefore account for any capital gain or capital loss on the disposal of the beneficial ownership of the Underlying Securities in the income year ended 30 June 2010 (or the substituted accounting period applicable to you). Should you make a capital loss, in circumstances where your Loan was not fully repaid because the proceeds from the sale of the Underlying Securities were less than the Completion Payment, it is likely that the Commissioner of Taxation would seek to reduce the cost base of the Underlying Securities by the amount of the shortfall.

You would also have made a capital loss equal to the reduced cost base of your Put Option (see above), which would have lapsed just after the Closing Time.

You may be eligible for the CGT discount for any capital gain made on disposal, if the Underlying Securities were acquired more than 12 months before the time of the CGT Event.

Underlying Securities:

Capital proceeds	Cash received (if any) + Completion Payment (to the extent to which your Loan was repaid).
Cost base	The cost base of the Underlying Securities, or the adjusted cost base where your Loan was not fully repaid from the proceeds of the sale of the Underlying Securities.
Capital gain	Where the capital proceeds > the cost base of the Underlying Securities you will make a capital gain; if not, a capital loss may arise.

Make Completion Payment

If you provided Westpac with a valid Completion Payment Notice, you would have received legal title to one underlying share per warrant. This should not have given rise to the disposal of the Underlying Parcel for the purposes of the CGT provisions. On making the Completion Payment however, you would have realised a capital loss on the lapsing of the Put Option for an amount equal to its reduced cost base. You will be entitled to a deduction for the remaining balance of any undeducted Borrowing Fees.

Capital losses can generally be offset against other capital gains derived during the income year or against future year capital gains.

4. Dividends and Distributions

Dividends and Special Dividends paid by the Underlying Securities are assessable to you. This is the case even if you do not physically receive the dividends, as is the case with Special Dividends where the dividends are used to reduce the Completion Payment.

Where dividends are wholly or partially "franked" and you are a "qualified person" in relation to the dividends, you are required to include an additional amount (representing the franking credits) in your assessable income and are entitled to a tax offset equal to this additional amount. The tax offset will reduce your tax liability and, in certain circumstances, an individual, superannuation fund or tax exempt entity may be entitled to a tax refund.

If the Underlying Securities are or include units in a listed trust (e.g. MIG), distributions from the trust should have the same character as the amounts derived by the trust (e.g. they may include capital gains, foreign tax credits or franked dividends). The tax composition of distributions from trusts are generally available from the relevant entities or their websites.
You should refer to the Tax section of the relevant PDS for further details on the tax treatment of these distributions.

Things you should know:

This Summary is provided for information purposes only and does not constitute tax advice.

Westpac does not provide taxation advice and we recommend that you speak to your professional taxation adviser for assistance when preparing your return. This Guide is based on current tax laws, interpretations and changes announced in the May 2010 Federal Budget that are yet to be enacted. The Guide has been prepared with the assistance of KPMG. The information contained in this Guide is current as at 30 June 2010.

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