

CR 2001/70 - Income tax: Preference Share Issue (Santos Ltd reset, convertible preference shares)

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⚠ This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in [TR 2006/10](#) provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *29 November 2006*



Class Ruling

Income tax: Preference Share Issue (Santos Ltd reset, convertible preference shares)

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings** TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. This Ruling relates to the application of the following provisions of the *Income Tax Assessment Act 1936* (‘The Act’):

- Section 160AQCB (Dividend streaming arrangements);
- Section 160AQCBA (Further provisions relating to dividend streaming); and
- Section 177EA (Creation of franking debit or cancellation of franking credits).

Class of persons

3. The class of persons to whom this Ruling applies is subscribers (“**Subscribers**”) of reset convertible preference shares (“**Preference Shares**”) in Santos Ltd (“**Santos**”) who hold those Preference Shares on their issue as described in the Arrangement part of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 9 to 22 is carried out in accordance with the details of the arrangement provided in this Ruling.
6. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:
 - (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
 - (b) this Ruling may be withdrawn or modified.
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Date of effect

8. This Class Ruling applies from the date on which Santos issues the Santos Preference Shares.

Arrangement

9. The description of this arrangement incorporates the application for the class ruling dated 20 September 2001, and the full draft Terms of Issue document, in relation to the proposal by Santos to issue the Preference Shares. Santos proposes to issue the Preference Shares in the near future. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description.

Note: certain information received from Santos has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information Legislation.

10. A minimum of \$250 million in Preference Shares will be on offer with Santos retaining the right to accept additional amounts up to \$100 million. The issue price will be \$100 per Preference Share. The Preference Shares will be listed on the Australian Stock Exchange (“*ASX*”).

11. The dividend rate will be set and fixed for the first five years of the Preference Shares prior to the issue and will be the higher of:

- 6.5% percent per annum; and
- the prevailing swap rate plus a certain margin 120 basis points per annum.

The dividend rate will be a margin above the five year swap rate.

12. Santos expects the dividends paid on the Preference Shares to be fully franked.

13. Dividends are non-cumulative but if not paid there are restrictions on the payment of dividends and return of capital to ordinary shareholders.

14. The dividend payment will be made semi-annually in March and September. The payment of a dividend is subject to:

- the Directors, at their discretion, declaring the dividend to be payable; and
- there being profits and funds legally available for the payment of the dividend.

15. After five years Santos is able to reset various terms on the Preference Shares. If any Preference Shares are unconverted immediately following a Reset Date, Santos may change:

- (a) the Dividend Rate applying from the relevant Reset Date until and including the next Reset Date;
- (b) the Dividend Payment Date until the next Reset Date;
- (c) the calculation of the price and the Conversion Discount until and including the next Reset Date; and
- (d) the next Reset Date.

16. Subscribers of Preference Shares may require Santos to convert or exchange (at Santos’ option) some or all Preference Shares:

- (a) on the first Reset Date, and on subsequent Reset Dates;
- (b) in the event that the dividend is not fully franked; or
- (c) after any of the following events occurs:

- (i) a Dividend is not paid in full within 20 business days after a Dividend Payment Date;
- (ii) Santos resolves in general meeting to be wound up;
- (iii) a provisional liquidator is appointed to Santos;
- (iv) a Court makes an order to wind-up Santos (other than to effect a solvent re-construction);
- (v) an administrator of Santos is appointed under sections 436A, 436B or 436C of the Corporations Act;
- (vi) Santos executes a deed of company arrangement;
- (vii) the Ordinary Shares or the Preference Shares are suspended from trading on ASX for more than 20 successive business days; or
- (viii) Santos announces to ASX an intention to sell all or substantially all of its business undertaking or assets (other than to effect a solvent re-construction).

17. Subscribers of Preference Shares may require Santos to convert some or all Preference Shares if:

- (a) a takeover bid is made to acquire all or some of the Ordinary Shares and the offer is, or becomes, unconditional and:
 - (i) the bidder has a relevant interest in more than 50% of the Ordinary Shares on issue;
 - (ii) the Directors issue a statement recommending acceptance of the offer; or
- (b) a court approves the convening of a meeting to consider a scheme of arrangement under Part 5.1 of the Corporations Act which, when implemented, will result in a person having voting power in the Company of more than 50%.

18. The Preference Shares may be converted into Santos ordinary shares with the Preference Shares Subscribers allotted an additional number of ordinary shares equal to one less than the Conversion Ratio based on a given formula. The conversion discount is in the range of 2.5% to 3% subject to the Santos share price.

19. Exchange in relation to the Preference Shares means Santos at its option, may either:

- (a) procure a third party to purchase the Preference Shares at its Face Value; or
- (b) redeem, buy back or cancel the Preference Shares for its Face Value.

In either case, payment to the Subscriber must be made on the conversion or exchange date determined under the terms of issue.

20. All or some of the Preference Shares may be converted or exchanged by Santos in the case of any of the following events occurring :

- (a) at least 21 business days (but no more than 6 months) before the Reset Date; or
- (b) if the Directors resolve (having obtained an opinion from reputable legal counsel or tax or accounting adviser) that a change in any law, interpretation, ruling issued by any relevant governmental body (including one relating to taxation) or accounting standard has occurred (or is announced) and that change will:
 - (i) materially increase the net costs to Santos of having Preference Shares on issue;
 - (ii) affect whether the Preference Shares can be franked or whether the holders are entitled to franking credits;
 - (iii) affect whether the Preference Shares are treated as debt or equity for tax or accounting purposes; or
 - (iv) impose additional requirements that the Directors consider unacceptable;
- (c) a takeover bid is made to acquire all or some of the Ordinary Shares and the offer is, or becomes, unconditional and:
 - (i) the bidder has a relevant interest in more than 50% of the Ordinary Shares on issue;
 - (ii) the Directors issue a statement recommending acceptance of the offer; or
- (d) a court approves the convening of a meeting to consider a scheme of arrangement under Part 5.1 of the Corporations Act which, when implemented, will result in a person having voting power in the Company of more than 50%.

21. The dividends on the Preference Shares will be paid in priority to any dividends declared on Ordinary Shares. In the event of a

winding up, the Preference Shares will rank for repayment of capital behind all creditors of Santos but ahead of Ordinary Shares.

22. The Subscribers of the Preference Shares have no right to vote at general meetings except in limited circumstances.

Ruling

23. Subject to the qualifications in paragraphs 4 to 7 of this Ruling, and in relation to the proposed offer by Santos of \$250 million in Preference Shares which will be listed on the Australian Stock Exchange, it is confirmed that:

- (a) Section 160AQCB of the Act has no application to the issue of the Preference Shares;
- (b) The Commissioner will not make a determination under paragraph 160AQCBA(3)(b) of the Act that denies franking credit benefits to a Subscriber for Preference Shares in respect of a franked dividend which is received by the Subscriber on those shares;
- (c) The Commissioner will not make a determination under paragraph 177EA(5)(b) of the Act that denies franking credit benefits to a Subscriber for Preference Shares in respect of any franked dividend which is received by the Subscriber on those shares.

Explanations

A. Application of Section 160AQCB

24. Under section 160AQCB, a franking debit arises for a company which undertakes a dividend streaming arrangement as defined in section 160APA. In order for there to be a dividend streaming arrangement as defined the shareholders must be given a choice or selection as to whether they receive a franked or unfranked dividend.

25. The arrangement described in paragraphs 9 to 22 does not give the shareholders such a choice or selection. Accordingly, it does not involve a dividend streaming arrangement of the type subject to this provision, and section 160AQCB will not apply.

B. Application of Section 160AQCBA

26. Section 160AQCBA applies where a company streams the payment of dividends, or streams the payment of dividends and the

giving of other benefits, to its shareholders in such a way as to give shareholders who benefit most from franking credits a greater franking credit benefit than those who would not benefit to the same degree.

27. Santos estimates that a portion of its ordinary shareholding is held by non-residents. These shareholders do not benefit to the same degree from franking credits as resident shareholders. The issue of the Preference Shares could constitute a mechanism for directing franking credits to the preference shareholders (who will in the main be residents) and away from the existing, non-resident, ordinary shareholders.

28. However, Santos anticipates that all dividends on ordinary shares will continue to be fully franked and that the rate of dividend paid on those shares will not be affected by the issue of the Preference Shares. Dividends payable on the Preference Shares will be franked to the same percentage as dividends paid on ordinary shares.

29. Accordingly, section 160AQCBA will not apply to the dividends paid on the Preference Shares. Furthermore, as long as all future dividends, whether paid on Preference Shares, ordinary shares, or any other class of shares issued by Santos, are fully franked and payout ratios remain unaffected the section should not apply.

C. Application of Section 177EA

30. Section 177EA is a general anti-avoidance provision that applies to a wide range of schemes to obtain a tax advantage in relation to franking credits. For the provision to apply paragraph 177EA(3)(e) requires that having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a franking credit benefit.

31. In this arrangement the relevant taxpayer is the Subscribers and the scheme comprises the circumstances surrounding the issue of Preference Shares and the buy-back of Ordinary Shares.

32. A relevant circumstance to consider is whether the Subscribers would in the year of income in which a dividend is paid derive a greater benefit than other shareholders. There is a class of Ordinary Shareholders, being the non-residents, who will derive a lesser benefit from the franking credits.

33. However, Santos anticipates that all dividends paid on Ordinary Shares will continue to be fully franked, the rate of dividend

paid on them will not be affected by the issue of the Preferences Shares and dividends payable on Preference Shares will be franked to the same percentage as dividends paid on Ordinary Shares. Therefore, this feature of the arrangement does not attract the application of section 177EA.

34. The scheme is a capital management strategy where ordinary shares are replaced with a less expensive form of capital, the Preference Shares, in order to achieve a more efficient capital structure. Santos expects that earnings per share and return on equity will be improved over time as a result of this strategy. Although it could be argued that the franking credit benefits were factored into the return on the Preference Shares by the Subscriber and contribute to the lower cost of funds to Santos having regard to all the relevant circumstances, both individually or collectively, it cannot be concluded that a Subscriber or Santos entered into the scheme for the purpose of enabling the Subscriber to obtain a franking credit benefit. Santos is issuing the Preference Shares to partly replace ordinary equity. But for the issue of the Preference Shares and buy-back of Ordinary Shares there would have been equity and franked dividends paid in respect of that equity. Ultimately, the scheme does not result in Santos avoiding wastage of franking credits.

35. Accordingly, section 177EA has no application to the Subscribers.

Detailed contents list

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Commissioner of Taxation28 November 2001

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 97/16

Subject references

- Dividend Streaming Arrangements
- Franking Credits

Legislative references:

- TAA 1953 Part IVAAA
- ITAA 1936 160APA
- ITAA 1936 160AQCBA
- ITAA 1936 160AQCBA(3)(b)
- ITAA 1936 160AQCBA(3)(b)
- ITAA 1936 177EA
- ITAA 1936 177EA(3)(e)
- ITAA 1936 177EA(5)(b)

ATO References

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