


# ***CR 2012/96 - Income tax: Bendigo and Adelaide Bank Limited - allotment of convertible preference shares (CPS)***

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## Class Ruling

### Income tax: Bendigo and Adelaide Bank Limited – allotment of convertible preference shares (CPS)

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#### **① This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

### Relevant provisions

2. The relevant provisions dealt with in this Ruling are:

- section 6BA of the *Income Tax Assessment Act 1936* (ITAA 1936);
- subsection 44(1) of the ITAA 1936;
- section 45 of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 177EA of the ITAA 1936;
- former Division 1A of Part IIIAA of the ITAA 1936;
- subsection 6-5(1) of the *Income Tax Assessment Act 1997* (ITAA 1997);

- Division 67 of the ITAA 1997;
- Division 104 of the ITAA 1997;
- section 109-10 of the ITAA 1997;
- Division 110 of the ITAA 1997;
- Subdivision 130-A of the ITAA 1997;
- section 204-30 of the ITAA 1997; and
- Division 207 of the ITAA 1997.

All legislative references are to the ITAA 1997 unless otherwise indicated.

## **Class of entities**

3. The class of entities to which this Ruling applies are subscribers of Convertible Preference Shares (CPS) in Bendigo and Adelaide Bank Limited (BEN) who hold those CPS on capital account and are Australian residents within the meaning of subsection 995-1(1) (the Holders).

4. The class of entities to which this Ruling applies does not extend to the holders of CPS who did not acquire their interest by initial subscription under the Prospectus.

5. The Ruling does not apply to Holders for whom gains and losses from the CPS are subject to the taxation of financial arrangements rules in Division 230.

(Note – Division 230 will generally not apply to the financial arrangements of individuals, unless they have made an election for those rules to apply to them.)

6. This Ruling does not consider the tax implications of the Exchange of CPS by Conversion or Redemption in accordance with clauses 5, 6 and 7 of the BEN CPS Terms of Issue described in paragraph 15 of this Ruling.

7. This Ruling does not consider the tax implications of the exchange or redemption of the BEN Reset Preference Shares (RPS) to reinvest in CPS.

8. This Ruling does not consider how the gross-up and tax offset rules apply to a Holder that is a partnership or trustee, or to indirect distributions to partners in a partnership, or trustees or beneficiaries of a trust.

9. This Ruling does not deal with how the taxation law applies to BEN in relation to the issue of the CPS.

## **Qualifications**

10. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

11. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 15 to 56 of this Ruling.

12. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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## Date of effect

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14. This Ruling applies from 24 October 2012 to 30 June 2020. The Ruling continues to apply after 30 June 2020 to all entities within the specified class who entered into the specified scheme at the time of the initial subscription for the CPS. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

## Scheme

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15. The following description of the scheme is based on information provided by the applicant. The following documents (Transaction Documents), or relevant parts of them, form part of and are to be read with the description:

- application for Class Ruling dated 8 August 2012;
- Prospectus for the issue of CPS by BEN provided on 24 September 2012 (Prospectus);
- final Terms of Issue of CPS by BEN provided on 24 September 2012 (Terms); and

- further correspondence provided in relation to the application between 30 August 2012 to 10 October 2012.

**Note:** Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

16. In this Ruling, unless otherwise defined, capitalised terms take the meaning as in the Terms.

17. During the term of the Ruling, BEN will be a resident of Australia under the income tax laws of Australia and of no other jurisdiction.

18. BEN announced its intention to raise approximately \$210 million through the offer of CPS with the ability to raise more or less than that amount (the Offer).

19. The funds raised from the issue of the CPS will be used for BEN's general corporate purposes and the offer of CPS is part of BEN's continuing capital management strategy within guidelines prescribed by the Australian Prudential Regulation Authority (APRA).

20. APRA has confirmed that the CPS will be treated as Non-Innovative Residual Tier 1 Capital under APRA's current prudential standard APS 111 and as Additional Tier 1 Capital after the introduction of Basel III in Australia on 1 January 2013 until at least 13 December 2017.

21. The Issue Date for BEN CPS is 1 November 2012. BEN CPS will also be listed on the Australian Securities Exchange (ASX) on this date and trade under the ASX code 'BENPD'.

22. The classes of Applicants who can apply for CPS, and the corresponding process for lodging applications, as described in the Prospectus, are:

- Securityholder Applicant – a holder of Ordinary Shares (or hybrid instruments) in BEN and with an address in Australia, applying through the Securityholder Offer;
- RPS holder Applicant – a holder of RPS and with an address in Australia applying through the Reinvestment Offer;
- Customer Applicant – an existing BEN retail customer who is an Australian resident applying through the Customer Offer;
- General Applicant – a member of the general public who is an Australian resident applying through the General Offer;
- Broker Firm Applicant – a retail client of a Syndicate Broker who is an Australian resident applying through the Broker Firm Offer; and

- Institutional Investor – a sophisticated or professional investor who was invited by the Joint Lead Managers to bid for CPS and who is not a Securityholder Applicant, Customer Applicant, General Applicant or Broker Firm Applicant, and who is applying through the Institutional Offer.

23. The Prospectus states that no action has been taken to register or qualify the CPS, or the Offer, or to otherwise permit a public offering of the CPS outside Australia. However, the CPS may be offered in a jurisdiction outside Australia under the Institutional Offer where such Offer is made in accordance with the laws of that jurisdiction.

### **Main features of the CPS**

24. The CPS are fully paid, unsecured, perpetual, non-cumulative, convertible preference shares in the capital of BEN.
25. The issue price of each CPS (Issue Price) will be \$100, and will be fully paid up to its \$100 face value on issue.
26. A Holder will not have voting rights under the CPS, except in the limited circumstances described in the Terms.

### **Dividend Calculation**

27. Subject to the conditions outlined in clause 3 of the Terms, a Holder is entitled to receive on the relevant Dividend Payment Date a dividend (Dividend) calculated according to the following formula:

$$\text{Dividend} = \frac{\text{Issue Price} \times \text{Dividend Rate} \times N}{365}$$

where:

**Dividend Rate** (expressed as a percentage per annum) is calculated using the following formula:

$$\text{Dividend Rate} = (\text{Bank Bill Rate} + \text{Margin}) \times (1 - \text{Tax Rate})$$

where:

**Bank Bill Rate** (expressed as a percentage per annum) means, for a Dividend Period, the average mid-rate for bills of a term of 180 days which is displayed on Reuters page BBSW (or any page which replaces that page) on the first Business Day of the Dividend Period or if there is a manifest error in the calculation of that average mid-rate or that average mid-rate is not displayed by 10.30am (Melbourne time) on that date, the rate specified in good faith by [BEN] at or around that time on that date having regard, to the extent possible, to:

- (a) the rates otherwise bid and offered for bills of a term of 180 days or for funds of that tenor displayed on Reuters page BBSW (or any page which replaces that page) at that time on that date; or
- (b) if bid and offer rates for bills of a term of 180 days are not otherwise available, the rates otherwise bid and offered for funds of that tenor at or around that time on that date.

**Margin** (expressed as a percentage per annum) means the margin determined by the Bookbuild.

**Tax Rate** (expressed as a decimal) means the Australian corporate tax rate applicable to the franking account of [BEN] as at the relevant Dividend Payment Date; and

**N** means in respect of:

- (a) the first Dividend Payment Date, the number of days from (and including) the Issue Date until (but not including) the first Dividend Payment Date; and
- (b) each subsequent Dividend Payment Date, the number of days from (and including) the preceding Dividend Payment Date until (but not including) the relevant Dividend Payment Date.

28. The Dividend Payment Dates are each 13 December and 13 June commencing on 13 December 2012 until (but not including) the date on which Redemption or Conversion of that CPS occurs. A Dividend may also be paid on the date on which a Conversion or Redemption occurs in accordance with the Terms.

29. Dividends are expected to be fully franked. However, if any dividend is not franked or only partially franked, the Dividend will be grossed-up to the extent that the franking percentage of the Dividends is less than 100%, as determined by the calculation in clause 3.2 of the Terms.

### ***Dividend Payment conditions***

30. Each Dividend is subject to:

- the Directors, at their absolute discretion, resolving to pay that Dividend on the relevant Dividend Payment Date; and
- no APRA Condition existing in respect of the relevant Dividend Payment Date:

- such payment of the Dividend not resulting in the Prudential Capital Requirement, the Tier 1 Capital Ratio, the Common Equity Tier 1 Capital Ratio or the Total Capital Ratio of BEN (on a Level 1 basis) or of the BEN Group (on a Level 2 basis or, if applicable, Level 3 basis) not complying with APRA's then current capital adequacy guidelines as they are applied to BEN or the BEN Group (as the case may be) at the time;
- unless APRA otherwise approves in writing, such payment of the Dividend not resulting in BEN or BEN Group exceeding any limit on distributions of earnings applicable under (and calculated in accordance with) APRA's then current capital conservation requirements at that time); or
- the payment of the Dividend not resulting in BEN becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001* (Corporations Act); and
- APRA not otherwise objecting to the payment of the Dividend.

31. A Dividend is only payable to those persons registered as the Holders on the Record Date for that Dividend.

32. The Dividends are non-cumulative and the Holders will not have any recourse in the event of non-payment arising because a resolution to pay a Dividend has not been made, an APRA Condition exists at the relevant Dividend Payment Date, or because of any applicable law. Non-payment of all, or part, of a Dividend does not constitute an event of default by BEN, and the Holders have no claim in respect of non-payment.

33. No interest accrues on any unpaid Dividends and the Holders have no claim or entitlement in respect of interest on any unpaid Dividends.

### ***Restrictions in the case of non-payment of Dividends***

34. If for any reason a Dividend has not been paid in full on a Dividend Payment Date (the Relevant Dividend Payment Date), BEN must not without approval of a Special Resolution, until and including the next Dividend Payment Date:

- declare or pay a dividend, or make any distribution on any Ordinary Shares; or
- buy back or reduce capital on any Ordinary Shares;

unless the Dividend is paid in full within 3 Business Days of the Relevant Dividend Payment Date.



## ***Conversion or Redemption of CPS***

35. The CPS will mandatorily Convert into Ordinary Shares in the circumstances referred to below. BEN may Redeem or Convert the CPS in certain circumstances, including Conversion on a Change of Control Event. Holders have no right to seek or initiate Conversion or Redemption.

## ***Mandatory Conversion***

36. Subject to a Capital Trigger Event, BEN must Convert all CPS on issue into Ordinary Shares on the Mandatory Conversion Date.

37. Subject to all of the Mandatory Conversion Conditions being satisfied, the Mandatory Conversion Date is the earlier of the Scheduled Mandatory Conversion Date on 13 December 2019 or each Dividend Payment Date after 13 December 2019 on which the Mandatory Conversion Conditions are satisfied.

38. The Mandatory Conversion Conditions for each Relevant Date (being the relevant Mandatory Conversion Date) are:

- the average of the daily volume weighted average sale prices (VWAP) of Ordinary Shares on the 25th Business Day on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Date (the First Test Date) is greater than 115% of the Conversion Floor Price;
- the VWAP during the period of 20 Business Days on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Date (the Second Test Period) is greater than 102.56% of the Conversion Floor Price; and
- either:
  - the Ordinary Shares remain listed and admitted to trading on the ASX; or
  - trading of Ordinary Shares on the ASX has not been suspended for at least five consecutive Business Days prior to that Mandatory Conversion Date and including that Mandatory Conversion Date.

## ***Capital Event Conversion***

39. 'Capital Event Conversion' means the mandatory conversion of CPS to Ordinary Shares on the Capital Event Conversion Date in accordance with clause 5.2 of the Terms on the occurrence of a Capital Trigger Event.

40. A Capital Trigger Event occurs when:
- (a) BEN's Common Equity Tier 1 Ratio of BEN Level 1 Group (on a Level 1 basis) or BEN Level 2 Group (on a Level 2 basis), as determined by BEN or APRA at any time is equal to or less than 5.125%;
  - (b) APRA notifies BEN in writing that conversion or write-off of Additional Capital Instruments is necessary because, without it, APRA considers that BEN would become non-viable; or
  - (c) APRA notifies BEN in writing that it has determined that BEN would become non-viable without a public sector injection of capital or equivalent support that has been committed to improve the capital position of BEN.

***Optional Exchange***

41. BEN may elect to Exchange at its discretion:
- (a) all, or some, CPS on an Exchange Date following the occurrence of a Tax Event or a Regulatory Event;
  - (b) all (but not some) CPS on the Exchange Date after the occurrence of an Acquisition Event; or
  - (c) all, or some, CPS on the Optional Exchange Date (being 13 December 2017).
42. If BEN elects to Exchange CPS, it must elect which of the following (or which combination of the following) it intends to do in respect of CPS:
- Convert the CPS into Ordinary Shares in accordance with clause 8 of the Terms; or
  - Redeem CPS in accordance with clause 9 of the Terms.
43. Redemption or Conversion of CPS on Optional Exchange is subject to, and in accordance with, the Terms; and is subject to APRA's prior written approval.

***Conversion mechanics***

44. 'Conversion' is defined by reference to the taking effect of the rights specified in clause 8 of the Terms.
45. Upon Conversion, each CPS converts into one Ordinary Share through a variation of the rights attaching to each CPS on the Mandatory Conversion Date, the Exchange Date, Capital Event Conversion Date or the Change of Control Conversion Date (as the case may be).

46. Each Holder will also be allotted, for no consideration, an additional number of Ordinary Shares for each CPS that is Converted. The additional number of Ordinary Shares allotted to the Holders will be equal to one less than the Conversion Number, where the Conversion Number (subject to the Conversion Number being no more than the Maximum Conversion Number) is a number calculated according to the formula provided in clause 8.1(b) of the Terms.

47. For Conversions on or after 1 January 2013, the Maximum Conversion Number is calculated as the Issue Price divided by 20% of the Issue Date VWAP.

48. Conversion does not constitute redemption, buy-back, cancellation or termination of CPS, nor does it constitute an issue, allotment or creation of a new Ordinary Share (other than any additional Ordinary Shares allotted).

## ***Redemption***

49. BEN may Redeem CPS in accordance with the Terms and subject to APRA's prior written approval.

50. 'Redeem' means redeem, buy-back (other than an on-market buy-back within the meaning of the Corporations Act) or reduce capital, or any combination of such activities.

51. Where CPS are Redeemed, BEN will pay the Issue Price plus any amount payable under clause 9.3(a)(3) of the Terms (together, the Redemption Price).

52. On the Exchange Date the only right the Holders will have in respect of CPS will be to obtain the Redemption Price payable in accordance with the Terms and, upon the payment of the Redemption Price all other rights conferred or restrictions imposed by CPS will no longer have effect.

## ***Interposition of Approved NOHC***

53. Clause 13.1 of the Terms provides for an Approved non-operating holding company (NOHC) Event.

54. A 'NOHC Event' means an event which:

- (a) is initiated by the Directors, acting as a board; and
- (b) would otherwise be an Acquisition Event,

but the result of which would be that an ultimate holding company of BEN would be a NOHC.

55. If an Approved NOHC Event occurs, BEN may give notice to the Holders specifying the amendments to the Terms to effect the substitution of the Approved NOHC as the issuer of Ordinary Shares to Holders on Conversion.

***Other matters***

56. The Ruling is made on the basis that:

- (a) the Transaction Documents represent a complete and accurate description of the transaction, are intended by parties to have their legal effect, and will be implemented according to their terms;
- (b) all parties to the transaction are dealing with each other on arm's length terms and fair value consideration will be provided by the Holders to acquire CPS;
- (c) the CPS are 'equity interests' in BEN pursuant to Division 974;
- (d) the additional Ordinary Shares issued in the event of Conversion of CPS will be equity interests in BEN pursuant to Division 974;
- (e) Dividends on CPS will be frankable distributions pursuant to section 202-40;
- (f) BEN will frank the Dividends paid on CPS at the same franking percentage as the benchmark for the franking period in which the payments are made;
- (g) BEN expects to have sufficient available profits from which to pay Dividends, and have net assets in excess of ordinary share capital, immediately before the payment of any Dividends payable in respect of the BEN CPS;
- (h) Dividends payable in respect of the CPS will not be sourced, directly or indirectly from BEN's share capital account or its non-share capital account;
- (i) No part of the Dividends will be sourced, directly or indirectly, from unrealised or untaxed profits;
- (j) the share capital of BEN will not become tainted within the meaning of Subdivision 197-A by the issue of CPS or the allotment of additional Ordinary Shares on Conversion of CPS;
- (k) the majority of the Holders are expected to be residents of Australia for tax purposes, although some may be foreign residents;
- (l) for the purposes of determining whether a Holder is a 'qualified person' under the former definition of 'qualified person' in subsection 995-1(1), a Holder has taken no positions (apart from the holding of CPS) in relation to their CPS and has not made, is not under an obligation to make, or is not likely to make, a related payment in relation to the Dividends;

- (m) the Holders in receipt of Dividends on CPS will have held their CPS for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the CPS), within the period beginning on the day after the day on which the Holder acquired CPS and ending on the 90th day after the day on which CPS become ex-dividend;
- (n) the dividend payout ratios or the franking credits in relation to the ordinary share capital or other preference share capital of BEN are not expected to materially change as a result of the issue of CPS;
- (o) on the date of Conversion of CPS into Ordinary Shares, the rights and obligations attached to those Ordinary Shares are the same as those contained in the Constitution of BEN; and
- (p) the accounts of the BEN group are prepared in accordance with the applicable accounting standards.

## Ruling

### Acquisition time of the CPS

57. Under section 109-10, the Holders will acquire the CPS on 1 November 2012, being the date the CPS will be issued to them.

### CPS cost base and reduced cost base

58. Under subsections 110-25(2) and 110-55(2), the first element of the cost base and reduced cost base of each CPS will be \$100.

### Inclusion of Dividends and franking credits in assessable income

59. The Holders must include in their assessable income all Dividends received in respect of their CPS under subparagraph 44(1)(a)(i) of the ITAA 1936, and an amount equal to the franking credit received on those Dividends under Division 207 of the ITAA 1997, unless the Holder is an entity whose ordinary or statutory income is exempt income.

### Entitlement to a tax offset

60. The Holders will be entitled to a tax offset equal to the franking credit received on the Dividends under subsection 207-20(2), unless Subdivision 207-D applies (refer to paragraph 62 of this Ruling).

61. The Holders who are entitled to a tax offset under Division 207, in respect of franking credits received, will also be subject to the refundable tax offset rules in Division 67. This is unless the Holders are specifically excluded from the refundable tax offset rules under section 67-25. Excluded entities include certain trustees and corporate tax entities under subsections 67-25(1A) to 67-25(1D).

#### **Exempt income or non-assessable non-exempt income**

62. If the Dividend (or a part of it) is either exempt income or non-assessable non-exempt income in the hands of the relevant Holder, then the amount of any franking credit on the Dividend is not included in the assessable income of the Holder and the Holder is not entitled to a tax offset under Division 207 (Subdivision 207-D).

#### **Imputation benefits – streaming**

63. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits received in relation to the Dividends received by the Holders in respect of the CPS.

#### **Section 177EA**

64. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received in relation to the Dividends received by the Holders in respect of the CPS.

#### **Gross-up and tax offset rules**

65. Section 207-145 will not apply to the whole, or any part, of the Dividends received by the Holders. Accordingly, section 207-145 will not adjust the gross-up of the Holders' assessable income to exclude the franking credit, nor will it deny the tax offset to which the Holders would have otherwise been entitled.

#### **Conversion of each CPS and allotment of additional Ordinary Shares – capital gains tax (CGT) implications**

66. The Conversion of each CPS into Ordinary Shares and the allotment of additional Ordinary Shares will not result in any CGT event occurring.

67. Specifically, CGT event C2 in section 104-25 will not occur upon the Conversion of the CPS into Ordinary Shares via a variation of rights and allotment of additional Ordinary Shares. Furthermore, CGT Event H2 in section 104-155 will not happen upon the Conversion of each CPS via a variation of rights and allotment of additional Ordinary Shares as a cost base adjustment will be made to the converted CPS because of the allotment of the additional Ordinary Shares.

## **Cost base of the additional Ordinary Shares**

68. Section 6BA of the ITAA 1936 and Subdivision 130-A of the ITAA 1997 will apply to apportion the first element of the cost base and reduced cost base of each CPS over the Converted CPS and any additional Ordinary Shares allotted by BEN.

## **Acquisition time of additional Ordinary Shares**

69. Under subsection 130-20(3), the additional Ordinary Shares will be taken to be acquired at the time CPS are originally acquired by the Holders, being 1 November 2012.

## **Allotment of additional Ordinary Shares – Dividend**

70. The allotment of any additional Ordinary Shares on Conversion of CPS will not be assessable as dividend income in the hands of the Holders.

## **The value of additional Ordinary Shares – ordinary income**

71. The value of any additional Ordinary Shares issued on Conversion of CPS will not be assessable as ordinary income in the hands of the Holders under subsection 6-5(1).

## **Conversion of each CPS and allotment of Ordinary Shares in an Approved NOHC – CGT implications**

72. Where an Approved NOHC becomes the ultimate holding company of BEN, the Conversion of each CPS and the allotment of NOHC Ordinary Shares to Holders will result in CGT event C2 happening (section 104-25).

73. However, no Holder will make a capital gain or capital loss as the capital gain or capital loss is disregarded under subsection 130-60(3).

74. The amendment to the Terms to effect the substitution of an Approved NOHC as the issuer of Ordinary Shares to Holders on Conversion of the CPS will result in CGT event H2 happening.

75. However, no Holder will make a capital gain or capital loss as a result of CGT event H2 happening as there will be no capital proceeds because of the amendments to the CPS Terms.

#### **Cost base of the Approved NOHC Ordinary Shares**

76. Under item 2 of the table in subsection 130-60(1), the first element of the cost base and the reduced cost base of each Approved NOHC Ordinary Share allocated to the Holders will be their cost base in the CPS at the time of Conversion divided by the number of Approved NOHC Ordinary Shares they receive for each CPS.

#### **Acquisition time of Approved NOHC Ordinary Shares**

77. Under subsection 130-60(2), the Approved NOHC Ordinary Shares will be taken to be acquired at the time of the Conversion of the CPS.

#### **Section 45**

78. Section 45 of the ITAA 1936 will not apply to treat the additional Ordinary Shares acquired on Conversion of the CPS as an unfranked dividend paid by BEN.

#### **Section 45A**

79. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that the additional Ordinary Shares acquired on Conversion of the CPS is an unfranked dividend in the hands of the Holders.

#### **Section 45B**

80. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that the additional Ordinary Shares acquired on Conversion of the CPS is an unfranked dividend in the hands of the Holders.

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**Commissioner of Taxation**

24 October 2012

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## Appendix 1 – Explanation

**①** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### **Acquisition time of the CPS**

81. An equity interest that is issued or allotted by a company is acquired when the contract is entered into or, if no contract exists, when the equity interests are issued or allotted (item 2 in the table in section 109-10).

82. The CPS will be issued on 1 November 2012. Therefore, for the purposes of item 2 in the table contained in section 109-10, the CPS will be acquired on 1 November 2012.

### **CPS cost base and reduced cost base**

83. The first element of the cost base and reduced cost base includes the money paid, or required to be paid, in respect of acquiring a CGT asset (paragraph 110-25(2)(a) and subsection 110-55(2)).

84. The Issue Price of each CPS will be \$100. Accordingly, when the CPS are issued, the first element of the cost base and reduced cost base of each CPS will be \$100.

### **Inclusion of Dividends and franking credits in assessable income**

85. Paragraph 44(1)(a) of the ITAA 1936 provides that the assessable income of a resident shareholder in a company includes dividends that are paid to the shareholder by the company out of profits derived by it from any source.

86. Dividends paid in respect of the CPS will be paid out of BEN's profits. Accordingly, the Holders must include the amount of the Dividends received by them in their assessable income.

87. Dividends paid in respect of the CPS are expected to be fully franked.

88. Under the Australian imputation system, where a franked distribution is paid by an Australian resident company to a shareholder, the assessable income of the shareholder must also include the franking credit attached to the dividend under Division 207. The inclusion of both the dividend and the associated franking credit in a shareholder's assessable income is termed 'grossing-up' the dividend receipt.

89. In accordance with subsection 207-20(2), and with respect to the 'grossing-up' of the dividend receipt, the Holders will be entitled to receive a tax offset equal to the value of the franking credit, which has been included in their assessable income.

### **Franking credit subject to the refundable tax offset rules**

90. The refundable tax offset rules ensure that certain taxpayers are entitled to a refund once their available tax offsets have been utilised to reduce any income tax liability to nil.

91. Accordingly, the Holders will be subject to the refundable tax offset rules unless they are listed as specifically excluded entities under section 67-25.

92. Entities excluded by Division 67 include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions as set out in subsections 67-25(1C) or 67-25(1D).

### **Exempt income or non-assessable non-exempt income**

93. Subdivision 207-D creates the appropriate adjustment to cancel the effect of the gross-up and tax offset rules where the Holder receives a franked distribution, and the franked distribution (or share of it) is, or would be, exempt income or non-assessable non-exempt income in the hands of the relevant Holder.

### **Imputation benefits – streaming**

94. Subdivision 204-D broadly enables the Commissioner to make a determination where distributions with attached imputation benefits are streamed to a member of a corporate tax entity in preference to another member.

95. Section 204-30 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 applies where an entity 'streams' the payment of distributions in such a way that:

- an 'imputation benefit' is, or apart from section 204-30 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a));
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)); and

- the other member (disadvantaged member) of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c)).

96. 'Streaming' is not defined for the purposes of Subdivision 204-D. However, the Commissioner has understood it to refer to a company 'selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits' (refer to paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002).

97. BEN has indicated that all the Holders will receive fully franked Dividends regardless of their tax attributes or their individual tax position. The dividend payout ratios or franking credits, in relation to the Ordinary Shares or other preference shares, will not be materially affected by the issue of the CPS.

98. The additional Ordinary Shares allotted on Conversion of CPS will not attract the application of section 204-30. This is because the issue of the additional Ordinary Shares will not constitute a distribution and the allotment of additional Ordinary Shares will not materially affect BEN's fully franked dividend policy.

99. Based on the information provided, the Commissioner has concluded that the requisite element of streaming does not exist in relation to the franked distributions to be paid by BEN to the Holders. Accordingly, based on the information provided, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny imputation benefits to the Holders.

## Section 177EA

100. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies where one of the purposes (other than an incidental purpose) of the scheme is to obtain an imputation benefit. In these circumstances, subsection 177EA(5) of the ITAA 1936 enables the Commissioner to make a determination with the effect of either:

- imposing franking debits or exempting debits on the distributing entity's franking account; or
- denying the imputation benefit on the distribution that flowed directly or indirectly to the relevant taxpayer.

101. Pursuant to subsection 177EA(3) of the ITAA 1936, the provision applies if the following conditions are satisfied:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
  - a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
  - a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the person (the relevant taxpayer) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) 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 a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

102. The Commissioner considers that the conditions in paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied.

103. Accordingly, the issue is whether having regard to the relevant circumstances of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

104. The relevant circumstances listed in subsection 177EA(17) of the ITAA 1936 encompass a range of circumstances which taken individually, or collectively, could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may or may not be present at any one time in any one scheme.

105. There are some relevant circumstances of the present arrangement that indicate a non-incidental purpose of enabling a holder to obtain an imputation benefit. In particular, the calculation of the Dividend by reference to the corporate tax rate, and that the Dividend is grossed-up if the Dividend is not fully franked, are matters going to paragraph 177EA(17)(f) of the ITAA 1936.

106. However, based on the information provided, the qualifications set out in this Ruling and consideration of all the relevant circumstances of the scheme, it would not be concluded that the purpose of enabling Holders to obtain imputation benefits is more than incidental to BEN's purpose of the raising of Tier 1 Capital to meet its capital adequacy requirements.

107. Accordingly, the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the imputation benefits to the Holders.

## **Gross-up and tax offset rules**

108. Subdivision 207-F creates the appropriate adjustment to cancel the effect of the gross up and tax offset rules where the entity concerned has manipulated the imputation system in a manner that is not permitted under the income tax law.

109. Pursuant to subsection 207-145(1) a 'manipulation of the imputation system' may occur where:

- the entity is not a 'qualified person' in relation to the distribution (paragraph 207-145(1)(a));
- the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in relation to the dividend (paragraph 207-145(1)(b) of the ITAA 1997);
- the Commissioner has made a determination under paragraph 204-30(3)(c) that no imputation benefit is to arise in relation to the distribution (paragraph 207-145(1)(c)); or
- the dividend is made as part of a dividend stripping operation (paragraph 207-145(1)(d)).

110. Generally, a person is a 'qualified person' for the purposes of Division 1A of former Part IIIA of the ITAA 1936 if they satisfy the holding period rule and the related payments rule (former section 160APHO of the ITAA 1936).

111. The holding period rule applies where neither the taxpayer nor an associate has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend, and requires the shares to have been continuously held at risk throughout the primary qualification period (former paragraph 160APHO(1)(a) of the ITAA 1936).

112. The related payments rule applies where the taxpayer or an associate has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend and requires the shares to have been continuously held at risk throughout the secondary qualification period (former subsection 160APHO(1) and former section 160APHN of the ITAA 1936).

113. The Holders will be qualified persons, provided that:

- the Holders will have held their CPS at risk for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the shares or interest) in the period beginning on the day after the day on which the Holders acquired CPS and ending on the 90th day after the day on which CPS become ex-dividend (former subsections 160APHO(2) and 160APHO(3) and former sections 160APHM and 160APHJ of the ITAA 1936); and
- neither the Holders, nor associates of the Holders, have made, are under an obligation to make, or are likely to make a related payment in relation to the Dividends on CPS (former paragraph 160APHO(1)(a) and former section 160APHN of the ITAA 1936).

114. If either, or both, of the above two considerations are not met, the Holders will not be a 'qualified person' for the purposes of Division 1A of former Part IIIA of the ITAA 1936. Subdivision 207-F of the ITAA 1997 will create the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for the Holders.

115. The Commissioner has confirmed that he will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Dividends paid by BEN to the Holders (see paragraphs 63 and 64 of this Ruling).

116. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to section 207-155, where the distribution arose out of, or was made in the course of, a scheme or substantially similar arrangement that was in the nature of dividend stripping.

117. The Transaction Documents provide no indication that the offering of CPS and the associated payment of franked Dividends to the Holders in any way constitute a dividend stripping arrangement. As such, the dividend stripping provision will have no application to the Holders.

## **Conversion of each CPS and allotment of additional Ordinary Shares – CGT implications**

118. Under the transaction, each CPS will convert into one Ordinary Share through a variation of the rights attaching to each CPS. The Holders will also receive an allotment of additional Ordinary Shares in BEN in accordance with the Terms.

119. Each CPS comprises of a bundle of rights; however, those rights are not separate pieces of property capable of being divided out and held separately. Accordingly, the rights attaching to each CPS do not constitute individual assets as defined by section 108-5, but rather combine to make up the relevant CGT asset, being the share (Taxation Ruling TR 94/30).

120. Under section 104-25, CGT event C2 happens if, among other things, the ownership of an intangible asset, such as a preference share, ends by the share:

- being redeemed or cancelled (paragraph 104-25(1)(a)); or
- if the share is a convertible interest – being converted (paragraph 104-25(1)(f)).

121. The mere variation of rights attaching to CPS and allotment of an additional number of Ordinary Shares for no consideration will not result in the ownership of an intangible CGT asset coming to an end by the share being redeemed or cancelled under paragraph 104-25(1)(a).

122. Further, the Conversion of CPS to Ordinary Shares by the variation of the rights attaching to CPS will not result in the ownership of an intangible CGT asset coming to an end by the CPS being converted under paragraph 104-25(1)(f).

123. The relinquishment by the Holders of some of the rights attaching to the CPS is not a CGT event that happens to part of the CGT asset comprised by each CPS under section 112-30 (paragraph 40 of TR 94/30).

124. As CGT event C2 will not occur on Conversion of CPS into Ordinary Shares, Subdivision 130-C will have no application.

125. Although CGT event C2 does not happen because of the variation of the rights attaching to CPS, the receipt of money or other consideration in respect of such a variation may attract the operation of CGT event H2 (paragraphs 9 and 46 to 48 of TR 94/30).

126. Subsection 104-155(1) provides that CGT event H2 happens if:

- (a) an act, transaction or event occurs in relation to a CGT asset that you own; and
- (b) the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

127. The Conversion of CPS involving the allotment of additional Ordinary Shares will result in an adjustment to the cost base and reduced cost base of the Converted CPS under Subdivision 130-A of the ITAA 1997 and section 6BA of the ITAA 1936.

128. Accordingly, CGT event H2 will not happen on the Conversion of CPS involving the allotment of additional Ordinary Shares.

129. No other CGT event in Division 104 will occur as a result of the Conversion of the CPS.

### **Cost base of the additional Ordinary Shares**

130. Section 6BA of the ITAA 1936 and Subdivision 130-A of the ITAA 1997 will apply to apportion the first element of the cost base and reduced cost base of the CPS over the Converted CPS and any additional Ordinary Shares issued by BEN.

131. Section 6BA of the ITAA 1936 applies if a shareholder holds shares in a company (the original shares) and the company issues other shares (the bonus shares) in respect of the original shares.

132. Pursuant to subsection 6BA(3) of the ITAA 1936, as the additional Ordinary Shares will be issued to Holders for no consideration and will not be a dividend or taken to be a dividend, the Issue Price of the CPS will be apportioned over the Converted CPS and any additional Ordinary Shares allotted.

133. Subdivision 130-A applies in a similar manner. It provides special rules relating to the time of acquisition and the cost base of bonus equities for CGT purposes.

134. Section 130-20 sets out what happens if an entity owns shares in a company (the original equities) and the company issues other shares (the bonus equities) in relation to the original equities.

135. Under item 1 of the table in subsection 130-20(3), as the additional Ordinary Shares will not be a dividend nor will they be taken to be a dividend, the first element of the cost base and reduced cost base of each CPS will be apportioned over both the Converted CPS and any additional Ordinary Shares issued to the Holders by BEN.

### **Acquisition time of additional Ordinary Shares**

136. The Holders will be taken to have acquired the additional Ordinary Shares at the time when the CPS are originally acquired by the Holders, being 1 November 2012 (subsection 130-20(3)).



## **Allotment of additional Ordinary Shares – dividend**

137. Subsection 6(1) of the ITAA 1936 defines a 'dividend' to include any distribution made by a company to any of its shareholders, whether in money or other property, and any amount credited by a company to any of its shareholders as shareholders.

138. Although the additional Ordinary Shares to be issued on Conversion of CPS will constitute 'property' in the hands of the Holders, the allotment will not be a disposition of property in the ordinary meaning of that expression (*Ord Forrest Pty Ltd v. FC of T* (1974) 130 CLR 124; 74 ATC 4034; (1974) 4 ATR 230, per Barwick CJ and McTiernan J). As there will be no disposition there cannot be a distribution of property by BEN.

139. The allotment of additional Ordinary Shares will not constitute a dividend under subsection 6BA(5) of the ITAA 1936 as the Terms do not provide Holders with a choice of being paid a dividend or being issued shares.

140. Furthermore, no amount will be credited to the Holders, nor will an amount be paid out of profits.

141. Accordingly, the allotment of additional Ordinary Shares will not constitute a dividend within the meaning of subsection 6(1) of the ITAA 1936.

## **The value of additional Ordinary Shares – ordinary income**

142. The allotment of additional Ordinary Shares will be a bonus issue within the meaning of paragraph 254A(1)(a) of the Corporations Act, that is, an issue of shares for which consideration is not payable to BEN. The issue of additional Ordinary Shares will result in a re-expression of the Holder's interest in the share capital of BEN.

143. Accordingly, the value of any additional Ordinary Shares issued on Conversion of CPS will not be assessable as ordinary income under subsection 6-5(1) (*Commissioner of Taxation v. McNeil* (2007) 229 CLR 656; 2007 ATC 4223; (2007) 64 ATR 431).

## **Conversion of each CPS and allotment of Ordinary Shares in an Approved NOHC – CGT implications**

144. The Terms provide for the possibility of an Approved NOHC to become the ultimate owner of BEN. If this occurs, BEN may amend the Terms and provide notice to Holders that upon Conversion, shares in the Approved NOHC will be allotted to the Holders instead of BEN Ordinary Shares.

**CGT event C2**

145. Under section 104-25, CGT event C2 happens if, among other things, the ownership of an intangible asset that is a convertible interest ends by the conversion of the asset into another asset (paragraph 104-25(1)(f)). If an approved NOHC becomes the ultimate owner of BEN, upon conversion, CGT Event C2 will occur as the CPS will be transferred to the Approved NOHC and Ordinary Shares in the Approved NOHC will be allotted to Holders.

146. However, Subdivision 130-C applies to the acquisition of shares by the conversion of a convertible interest. In order for this Subdivision to apply to the Conversion of the CPS, the CPS must be a convertible interest. If the CPS is a convertible interest any capital gain or capital loss made under CGT event C2 happening in respect to the Conversion of the CPS is disregarded.

147. A convertible interest in a company is defined in section 995-1 as an interest of the kind referred to in item 4 of the table in subsection 974-75(1). Paragraph (b) of that item describes an interest that will or may convert into an equity interest in the company or a connected entity of the company.

148. The term 'an interest that will or may convert into another interest' is defined in section 974-165. It includes the circumstances where a first interest must be, or may be, satisfied by the issue of the second interest (subparagraph 974-165(b)(i)).

149. The term 'connected entity' is defined in section 995-1 of the ITAA 1997 and includes an 'associate' of the entity being tested. 'Associate' is widely defined in section 995-1 of the ITAA 1997 and section 318 of the ITAA 1936.

150. The CPS is considered to be an interest that will or may convert into another interest and as the Approved NOHC will be the parent company of BEN at the time of the Conversion, the Approved NOHC will be an associate, and thus a connected entity of BEN.

151. Accordingly, upon such a Conversion, Holders will disregard any capital gain or loss arising from that Conversion pursuant to subsection 130-60(3).

**CGT event H2**

152. An approved NOHC becoming the ultimate owner of BEN will not, by itself, result in a CGT event for Holders in respect of their CPS.

153. However, subsection 104-155(1) provides that CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset that you own and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

154. The amendment to the Terms to effect the substitution of an Approved NOHC as the issuer of Ordinary Shares on Conversion results in a CGT event H2 happening for Holders. The amendment to the Terms is an act, transaction or event in relation to the CPS that does not result in an adjustment being made to the cost base or reduced cost base of the CPS.

155. A capital gain is made if the capital proceeds from the CGT event H2 are more than the incidental costs incurred in relation to the event. A capital loss is made if the capital proceeds are less than the incidental costs (subsection 104-155(3)).

156. Subsection 116-20(2) provides that the capital proceeds from CGT event H2 happening is the money or other consideration received, or entitled to be received, because of the act, transaction or event.

157. Holders will not make a capital gain or capital loss from the happening of CGT event H2 as there will be no capital proceeds because of the amendments to the Terms and no incidental costs will be incurred by the Holders that relate to these amendments. No other CGT event will happen because of the amendments to the Terms.

## **Cost base of the Approved NOHC Ordinary Shares**

158. Under item 2 of the table in subsection 130-60(1), the first element of the cost base and the reduced cost base of each Approved NOHC Ordinary Share allocated to a Holder will be their cost base in the CPS at the time of Conversion divided by the number of Approved NOHC Ordinary Shares they receive for each CPS.

## **Acquisition time of the Approved NOHC Ordinary Shares**

159. Under subsection 130-60(2), the Approved NOHC Ordinary Shares will be taken to be acquired at the time of the Conversion of the CPS. This means that the 12 month holding period for the purposes of the CGT discount, as regards the Approved NOHC Ordinary Shares, will run from the acquisition date of the Approved NOHC Ordinary Shares and not from the acquisition of the CPS.

## **Section 45**

160. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

161. BEN has consistently paid fully franked dividends and has stated it will pay fully franked dividends to all its shareholders, including the Holders, to the extent of the franking credits available in its franking account. Furthermore, the Terms do not allow BEN to issue Ordinary Shares to all or some of the Holders in satisfaction of their dividend entitlements in relation to the CPS.

162. Therefore, section 45 of the ITAA 1936 will not apply to the additional Ordinary Shares acquired on Conversion of the CPS.

### **Section 45A**

163. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

164. The allotment of additional Ordinary Shares to the Holders will be a provision of capital benefits pursuant to paragraph 45A(3)(a) of the ITAA 1936.

165. The allotment of additional Ordinary Shares will be in effect a restatement of the Holders' interest in the capital of BEN. In the absence of any other additional factors that would contribute to an alternative conclusion, the allotment of additional Ordinary Shares will not constitute the streaming of capital benefits.

166. Accordingly, it cannot be said that the Holders will derive a greater benefit from capital benefits than other BEN shareholders. Therefore, the allotment of additional Ordinary Shares will not trigger the application of section 45A of the ITAA 1936 and the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that the additional Ordinary Shares acquired on Conversion of the CPS will be an unfranked dividend in the hands of the Holders.

### **Section 45B**

167. Section 45B of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends.

168. The allotment of additional Ordinary Shares on Conversion of CPS will be a scheme under which a capital benefit is provided to the Holders (paragraph 45B(5)(a) of the ITAA 1936).

169. For the provision to apply, paragraph 45B(2)(c) of the ITAA 1936 requires that, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit. The relevant circumstances of the scheme are listed in subsection 45B(8) of the ITAA 1936.

170. The allotment of additional Ordinary Shares will not be in satisfaction of the Holders' entitlement to Dividends, but rather a product of the Conversion of the CPS held by the Holders according to the Terms. Consequently, each Holder's interest in the share capital of BEN will not change when the capital benefit is provided. Furthermore, BEN has paid, and has stated it will continue to pay, franked dividends to all its shareholders to the extent of the franking credits available.

171. Having regard to these relevant circumstances of the scheme, as required by subsection 45B(8) of the ITAA 1936, it would not be concluded that any of the parties to the scheme entered into or carried out the scheme for a more than incidental purpose of enabling the Holders to obtain a tax benefit. Therefore, section 45B of the ITAA 1936 will not apply to treat the additional Ordinary Shares acquired on Conversion as an unfranked dividend in the hands of the Holders.

172. Accordingly the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936.

## **Appendix 2 – Detailed contents list**

173. The following is a detailed contents list for this Ruling:

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## References

### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 94/30; TR 2006/10

### *Subject references:*

- acquisition dates
- capital gains tax
- CGT cost base
- conversion of securities
- dividend imputation
- dividend income
- dividend streaming arrangements
- franking tax offset
- preference shares

### *Legislative references:*

- ITAA 1936 6(1)
- ITAA 1936 6BA
- ITAA 1936 6BA(3)
- ITAA 1936 6BA(5)
- ITAA 1936 44(1)
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- ITAA 1936 45A(3)(a)
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ATOlaw topic: Income Tax ~~ Assessable income ~~ dividend  
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