CR 2023/12 - Warwick Credit Union Limited - Capital Notes

Status: **legally binding**

Class Ruling

Warwick Credit Union Limited – Capital Notes

Relying on this Ruling

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Table of Contents	Paragraph

What this Ruling is about

1. This Ruling sets out income tax consequences for specified entities who applied for the issue of and acquired Capital Notes issued by Warwick Credit Union Limited (WCU) on 15 December 2022 (WCU Capital Notes) under the Information Statement dated 13 December 2022 (IS).

2. Details of this scheme are set out in paragraphs 33 to 55 of this Ruling.

3. In this Ruling, unless otherwise defined, capitalised terms have the meaning specified in the Terms of the WCU Capital Notes (Terms) which are contained in the IS.

4. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Who this Ruling applies to

5. This Ruling applies to you if you are an investor in WCU Capital Notes (also referred to as a Holder) who:

- acquired WCU Capital Notes by initial application for the issue of WCU Capital Notes under the IS
- is a resident of Australia within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) during the period in which you hold your WCU Capital Notes
- holds your WCU Capital Notes on capital account, and

- is not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on your WCU Capital Notes.

Note: Division 230 will not apply to individuals unless they have made an election for it to apply.

What this Ruling does not consider

6. This Ruling does not deal with:

- the tax implications in relation to a non-resident who holds their WCU Capital Notes through a permanent establishment (as defined in subsection 6(1) of the ITAA 1936) in Australia
- the tax implications of Conversion or Write-off of WCU Capital Notes on the occurrence of a Non-Viability Trigger Event, or
- how the gross-up and tax offset rules in Division 207 apply to partnership or trustee investors (other than a partnership or trustee that is a corporate tax entity, or a trustee of a trust that is a complying superannuation entity), or to indirect distributions to partners in a partnership or beneficiaries or trustees of a trust.

When this Ruling applies

7. This Ruling applies from 1 July 2022 to 30 June 2028.

Ruling

Consequences of acquiring Warwick Credit Union Limited Capital Notes

Acquisition date of Warwick Credit Union Limited Capital Notes

8. You acquired your WCU Capital Notes on 15 December 2022 under table item 2 of section 109-10.

Cost base and reduced cost base of each Warwick Credit Union Limited Capital Note

9. The first element of the cost base and reduced cost base of each WCU Capital Note is A$10,000, being the money you paid to acquire each of your WCU Capital Notes (subsections 110-25(2) and 110-55(2)).

Consequences of holding Warwick Credit Union Limited Capital Notes

Distributions on Warwick Credit Union Limited Capital Notes and entitlement to tax offset for franking credits

10. A Distribution on a WCU Capital Note is a non-share dividend under section 974-120 and is included in your assessable income (subparagraph 44(1)(a)(ii) of the ITAA 1936).

11. In the income year in which a Distribution is made (section 207-20), you also:

- include the amount of the franking credit attached to the Distribution in your assessable income, and
- are entitled to a tax offset equal to the franking credit.

12. To the extent that a Distribution (or a part of it) is either exempt income or non-assessable non-exempt income in your hands (and none of the exceptions in Subdivision 207-E apply), the amount of any franking credit on the Distribution that is exempt income or non-assessable non-exempt income is not included in your assessable income, and you are not entitled to a tax offset under Division 207 (Subdivision 207-D).

13. The franking credit tax offset that you are entitled to under Division 207 is subject to the refundable tax offset rules in Division 67, provided you are not excluded by the operation of section 67-25. Entities excluded by section 67-25 include corporate tax entities (such as companies, corporate limited partnerships and public trading trusts), unless they satisfy the requisite conditions in subsections 67-25(1C) or (1D).

Determination under paragraph 177EA(5)(b) of the ITAA 1936

14. 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 you receive in relation to a Distribution.

Determination under paragraph 204-30(3)(c)

15. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits you receive in relation to a Distribution.

Gross-up and tax offset cancelled in certain circumstances

16. Paragraph 207-145(1)(a) will not apply to cancel the effect of the gross-up and tax offset in respect of a franked Distribution if you are a qualified person in respect of that Distribution.

17. You will be a qualified person in relation to a Distribution if, during the primary qualification period, you held your WCU Capital Notes for a continuous period of at least 90 days during which you did not have ‘materially diminished risks or loss of opportunities for gain’ (as defined in former section 160APHM of the ITAA 1936) in respect of your WCU Capital Notes.

18. Paragraphs 207-145(1)(b) to (db) will not apply to cancel the effect of the gross-up and tax offset rules in respect of a franked Distribution.

19. In respect of paragraphs 207-145(1)(b) and (c), refer to paragraphs 14 and 15 of this Ruling.

20. In respect of paragraph 207-145(1)(d), there is no evidence that the Distributions will be made as part of a dividend stripping operation.

21. In respect of paragraph 207-145(1)(da), the distribution washing provision does not apply (refer to subparagraph 55(t) of this Ruling).

22. In respect of paragraph 207-145(1)(db), the WCU Capital Notes are equity interests which form part of WCU's Additional Tier 1 Capital (refer to subsection 207-158(2) and subparagraph 55(d) of this Ruling).

Consequences of disposing of Warwick Credit Union Limited Capital Notes

Warwick Credit Union Limited Capital Notes are not traditional securities

23. A WCU Capital Note is not a 'traditional security' as defined in subsection 26BB(1) of the ITAA 1936.

24. Section 26BB of the ITAA 1936 will not apply to include any gain on the disposal or Redemption of WCU Capital Notes in your assessable income.

25. Section 70B of the ITAA 1936 will not apply to allow any loss on the disposal or Redemption of WCU Capital Notes as a deduction to you.

Early Redemption of Warwick Credit Union Limited Capital Notes

26. CGT event C2 happens when a WCU Capital Note is Redeemed for its Face Value (section 104-25).

27. The capital proceeds received by Holders on Redemption of the WCU Capital Notes will be replaced with the market value of the WCU Capital Notes on the Redemption Date, worked out as if the Redemption had not occurred and was never proposed to occur, if the capital proceeds are more or less than the market value of the WCU Capital Notes (subparagraph 116-30(2)(b)(ii)).

28. You will make a capital gain (or capital loss) on Redemption of your WCU Capital Notes if the capital proceeds you receive are greater than (or less than) the cost base of your WCU Capital Notes.

29. As you hold your WCU Capital Notes on capital account, no amount will be included in your assessable income on the Redemption under section 6-5.

30. In addition, you will not incur a deductible loss under section 8-1 as a consequence of the Redemption.

Other integrity provisions

Section 45A of the ITAA 1936

31. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or a part, of the capital benefit provided to you on Redemption as an unfranked dividend.

Section 45B of the ITAA 1936

32. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or a part, of the capital benefit provided to you on Redemption as an unfranked dividend.

Scheme

33. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

Background

34. WCU is an Australian unlisted public company limited by shares. WCU operates as a mutual banking organisation owned and controlled by its customer shareholders.

35. WCU is an authorised deposit-taking institution for the purposes of the *Banking Act 1959* and is regulated by the Australian Prudential Regulation Authority (APRA).

36. WCU is an Australian resident as defined in subsection 995-1(1) and is not a resident of any other jurisdiction.

Main features of Warwick Credit Union Limited Capital Notes

37. WCU Capital Notes are Australian dollar-denominated perpetual, subordinated, unsecured debt obligations in the form of unsecured notes issued by WCU.

38. WCU Capital Notes were issued by WCU in Australia on the Issue Date, being 15 December 2022.

39. The WCU Capital Notes offer raised Additional Tier 1 Capital as part of WCU's capital management policy within the regulatory capital requirements prescribed by APRA. The proceeds from the issue are to be used by WCU for general corporate purposes, including for the replacement of an existing issuance of capital notes that raised Additional Tier 1 Capital in 2017.

40. The offer for issue was only open to eligible professional or sophisticated investors in accordance with Part 6D.2 of the *Corporations Act 2001* and raised A$6 million from a mix of institutional and non-institutional investors.

Issue price

41. The issue price (Face Value) of each WCU Capital Note was A$10,000. WCU Capital Notes were fully paid on the Issue Date.

Distributions

42. Subject to the Terms, WCU will pay quarterly cash Distributions on the Face Value of each WCU Capital Note on the relevant Distribution Payment Date.

43. The Distribution payable is calculated as the Face Value of each WCU Capital Note, multiplied by a Distribution Rate (which is equal to the BBSW Rate[1] plus the Margin, together multiplied by the Franking Adjustment Factor) and multiplied by the number of days in the relevant Distribution Period, together divided by 365.

[1] In this Ruling, BBSW Rate takes the definition provided in Clause 3.1 of the Terms (which is not replicated here).

44. The payment of any Distribution on a Distribution Payment Date is subject to WCU's absolute discretion and no Payment Condition existing (such conditions relate to, for example, APRA's capital adequacy requirements applicable to WCU).

45. Payments of Distributions are non-cumulative. If all or any part of a Distribution is not paid for any reason, WCU has no liability to pay any unpaid amount of the Distribution, Holders have no claim or entitlement in respect of such non-payment, and such non-payment does not constitute an event of default. No interest accrues on any unpaid Distributions and Holders have no claim or entitlement in respect of interest on any unpaid Distributions.

46. Subject to certain exceptions, if for any reason a Distribution has not been paid in full on a Distribution Payment Date, WCU must not, without the approval of a Special Resolution, until and including the next Distribution Payment Date declare, determine to pay or pay a Dividend on any MEIs[2] (assuming that MEIs are on issue at the time), unless the Distribution is paid in full within 5 Business Days of that Distribution Payment Date.

Conversion or Write-off on Non-Viability Trigger Event

47. A Non-Viability Trigger Event means APRA has notified WCU that APRA considers that:

- the conversion into MEIs or write-off of Relevant Securities in accordance with their terms or by operation of law is necessary because without the conversion to MEIs or write-off, WCU would become non-viable, or
- without a public sector injection of capital, or equivalent support, WCU would become non-viable.

48. If a Non-Viability Trigger Event occurs, WCU must immediately either Convert into MEIs or Write-off all Relevant Securities, or where APRA is satisfied that conversion or write-off of a proportion of Relevant Securities will be sufficient to ensure that WCU will not become non-viable, that proportion of Relevant Securities.

49. Upon Conversion:

- you will be issued a Conversion Number of MEIs for every WCU Capital Note held, and
- your rights (including to payment of Distributions) in relation to each WCU Capital Note that is being Converted will be immediately and irrevocably terminated for an amount equal to the Face Value of that WCU Capital Note and WCU will apply the Face Value of each WCU Capital Note by way of payment for subscription for the Conversion Number of MEIs.

Early Redemption

50. WCU may, with APRA's prior written approval, Redeem by payment of their Face Value (Redemption Price):

- all (but not some) WCU Capital Notes on the occurrence of a Tax Event or a Regulatory Event, or
- all or some WCU Capital Notes on 15 December 2027 or on a Distribution Payment Date occurring after that date.

[2] In this Ruling, MEI takes the definition provided in Clause 13.2 of the Terms (which is not replicated here).

51. WCU may only Redeem WCU Capital Notes if either:

- prior to or concurrently with Redemption, WCU replaces the WCU Capital Notes with a capital instrument of the same or better quality and the replacement of the instrument is done under conditions that are sustainable for WCU's income capacity, or
- WCU obtains confirmation from APRA that APRA is satisfied that WCU does not have to replace the WCU Capital Notes.

52. A Holder cannot require WCU or any other person to Redeem a WCU Capital Note.

53. WCU Capital Notes will be Redeemed by payment of the Redemption Price on the Redemption Date to the Holder.

54. On the Redemption Date, the only right the Holders will have in respect of WCU Capital Notes will be to obtain the Redemption Price payable in accordance with the Terms. Upon the payment of the Redemption Price, all other rights conferred, or restrictions imposed, by WCU Capital Notes will no longer have effect.

Other matters

55. This Ruling is made on the basis that:

(a) During the term of the scheme, WCU is a resident of Australia under the income tax laws of Australia and of no other jurisdiction.

(b) The majority of the Holders who acquired WCU Capital Notes under the offer for issue were residents of Australia for tax purposes, although some may be non-residents.

(c) WCU Capital Notes are equity interests in WCU and non-share equity interests as defined in subsection 995-1(1).

(d) WCU Capital Notes form part of WCU's Additional Tier 1 Capital for the purposes of the prudential standards determined by APRA and in force under section 11AF of the *Banking Act 1959*.

(e) Distributions will be frankable distributions as defined in section 202-40.

(f) WCU will frank Distributions at the same franking percentage as the benchmark franking percentage for the franking period in which the distributions are made.

(g) Distributions on WCU Capital Notes are not sourced, directly or indirectly, from WCU's share capital account or its non-share capital account.

(h) Distributions paid on WCU Capital Notes will not be debited against WCU's share capital account or non-share capital account.

(i) Immediately before the payment of a Distribution, WCU expects that the amount of its available frankable profits will be such that no part of a Distribution is taken to be unfrankable under section 215-15.

(j) WCU expects that future tax payments will generate sufficient franking credits for WCU to fully frank frankable distributions on all equity interests.

(k) WCU will not differentially frank Distributions to different Holders according to their tax status or on any other basis.

(l) WCU, as a mutual entity, does not make distributions on its member shares.

(m) WCU's share capital account did not become tainted under Division 197 as a result of issuing the WCU Capital Notes and will not become tainted as a result of issuing MEIs on Conversion.

(n) If WCU Capital Notes are Redeemed, the Face Value payable to you will be debited in full to WCU's non-share capital account.

(o) MEIs issued on Conversion will be equity interests in WCU as defined in Subdivision 974-C and constitute Tier 1 Capital.

(p) WCU does not currently have on issue any other equity interests as defined in Subdivision 974-C that constitute Tier 1 Capital.

(q) You will not take any 'positions' (as defined in former section 160APHJ of the ITAA 1936) at any time in relation to your WCU Capital Notes apart from holding your WCU Capital Notes.

(r) You (or an associate) will not make, be under an obligation to make, or be likely to make, a 'related payment' (as defined under former section 160APHN of the ITAA 1936) in relation to a Distribution.

(s) You will hold your WCU Capital Notes for a continuous period of at least 90 days (excluding the day of acquisition and disposal (if relevant)), during the 'primary qualification period' (as defined in former section 160APHD of the ITAA 1936) in relation to a Distribution.

(t) You (or your connected entities) will not engage in distribution washing (as outlined in section 207-157) in relation to a Distribution (unless entitled to the exception under subsection 207-157(4)).

(u) All parties to the transaction are dealing with each other on arm's length terms.

Commissioner of Taxation
15 March 2023

Appendix – Explanation

This Explanation 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.

Table of Contents **Paragraph**

Determination under paragraph 177EA(5)(b) of the ITAA 1936

56. 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 a particular scheme is to enable a taxpayer to obtain an imputation benefit.

57. The conditions in paragraphs 177EA(3)(a) to (d) of the ITAA 1936 will be satisfied, therefore the relevant circumstances of the scheme must be considered to establish whether any person who entered into or carried out the scheme, or any part of the scheme, did so for a more than incidental purpose of enabling a Holder to obtain an imputation benefit (paragraph 177EA(3)(e) of the ITAA 1936).

58. The Commissioner considers that the relevant circumstances of the scheme do not, on balance, lead to a conclusion that the purpose of enabling Holders to obtain imputation benefits is more than incidental to WCU's primary purpose of raising Additional Tier 1 Capital for regulatory capital requirements and continuing to operate within capital ratios.

Determination under paragraph 204-30(3)(c)

59. Subsection 204-30(1) empowers the Commissioner to make a determination under paragraph 204-30(3)(c) if an entity streams distributions in a certain way.

60. Based on the scheme, there is no evidence of streaming. Distributions will be received by all Holders by reason of their proportionate holding of WCU Capital Notes and not by reference to their tax profiles or individual tax positions. There is nothing in the Terms that allows WCU to treat Holders differently in respect of their entitlement to a franked Distribution.

Gross-up and tax offset denied in certain circumstances – qualified persons

61. If you are not a qualified person in relation to a Distribution, you:

- do not include the franking credit attached to the Distribution in your assessable income (paragraph 207-145(1)(e)), and
- are not entitled to a tax offset equal to the amount of the franking credit attached to the Distribution (paragraph 207-145(1)(f)).

62. As this Ruling is made on the basis that you have not made a related payment in respect of a Distribution, the relevant qualification period is the 'primary qualification period' (as defined in former section 160APHD of the ITAA 1936). The primary qualification period begins on the day after you acquired your WCU Capital Notes and ends on the 90th day after the day WCU Capital Notes become ex-distribution.

63. You need to have held your WCU Capital Notes 'at risk' for a continuous period of 90 days (excluding the days of acquisition and disposal, if relevant) during the primary qualification period. Any days you had materially diminished risks of loss or opportunities for gain in respect of your holding are also excluded (former subsection 160APHO(3) of the ITAA 1936).

64. Under former subsection 160APHM(2) of the ITAA 1936, you are taken to have materially diminished the risks of loss and opportunities for gain on a particular day with respect to your WCU Capital Notes if your net position on that day does not retain 30% or more of the risks and opportunities associated with holding WCU Capital Notes.

Section 45A of the ITAA 1936

65. Section 45A of the ITAA 1936 applies where a company streams capital benefits and the payment of dividends to shareholders who would derive a greater benefit from receiving the capital benefits (the advantaged shareholders), and it is reasonable to assume that other shareholders (the disadvantaged shareholders) have received, or will receive, dividends.

66. The Redemption of WCU Capital Notes will constitute the provision of a capital benefit to Holders (paragraph 45A(3)(b) of the ITAA 1936 as affected by subsection 45A(3A) of the ITAA 1936).

67. However, the Redemption of WCU Capital Notes will not constitute the streaming of capital benefits because, under a Redemption, WCU will not selectively direct the flow of capital benefits to Holders who could most benefit from the receipt of capital. Accordingly, as this requirement does not apply to the Redemption of WCU Capital Notes, the Commissioner will not make a determination to treat the whole, or a part, of the capital benefit received by Holders as an unfranked dividend.

Section 45B of the ITAA 1936

68. Section 45B of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends. Where the conditions are met, the Commissioner may make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or a part, of the capital benefit such that it will be treated as an unfranked dividend.

69. The Redemption of WCU Capital Notes will constitute a scheme under which Holders are provided with a capital benefit by WCU (paragraph 45B(5)(b) as affected by subsection 45B(7) of the ITAA 1936). As a result, paragraph 45B(2)(a) of the ITAA 1936 will be satisfied.

70. At least some Holders will obtain a tax benefit as defined in subsection 45B(9) of the ITAA 1936 as a result of a Redemption. Accordingly, paragraph 45B(2)(b) of the ITAA 1936 will be satisfied.

71. Therefore, whether section 45B of the ITAA 1936 will apply to a Redemption of WCU Capital Notes turns on whether paragraph 45B(2)(c) of the ITAA 1936 will be satisfied. This involves considering the relevant circumstances of the Redemption scheme

including, but not limited to, those listed in subsection 45B(8) of the ITAA 1936, to establish whether one of the persons who will enter into or carry out the scheme will do so for a more than incidental purpose of enabling a relevant taxpayer (the Holder) to obtain a tax benefit.

72. Having regard to the relevant circumstances, it would not be concluded that the Redemption of WCU Capital Notes will be entered into for a more than incidental purpose of enabling Holders to obtain a tax benefit. Accordingly, paragraph 45B(2)(c) of the ITAA 1936 would not be satisfied and the Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or a part, of the capital benefit provided to Holders on Redemption.

References

Legislative references:
- ITAA 1936 6(1)
- ITAA 1936 26BB
- ITAA 1936 26BB(1)
- ITAA 1936 44(1)(a)(ii)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3A)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)(b)
- ITAA 1936 45B(5)(b)
- ITAA 1936 45B(7)
- ITAA 1936 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 70B
- ITAA 1936 former 160APHD
- ITAA 1936 former 160APHJ
- ITAA 1936 former 160APHM
- ITAA 1936 former 160APHM(2)
- ITAA 1936 former 160APHN
- ITAA 1936 former 160APHO(3)
- ITAA 1936 177EA
- ITAA 1936 177EA(3)(a)
- ITAA 1936 177EA(3)(b)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(3)(e)
- ITAA 1936 177EA(5)(b)
- ITAA 1997 6-5
- ITAA 1997 8-1
- ITAA 1997 Div 67
- ITAA 1997 67-25
- ITAA 1997 67-25(1C)
- ITAA 1997 67-25(1D)
- ITAA 1997 104-25
- ITAA 1997 109-10
- ITAA 1997 110-25(2)
- ITAA 1997 110-55(2)
- ITAA 1997 116-30(2)(b)(ii)
- ITAA 1997 Div 197
- ITAA 1997 202-40
- ITAA 1997 204-30(1)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 Div 207
- ITAA 1997 Subdiv 207-D
- ITAA 1997 Subdiv 207-E
- ITAA 1997 207-20
- ITAA 1997 207-145(1)(a)
- ITAA 1997 207-145(1)(b)
- ITAA 1997 207-145(1)(c)
- ITAA 1997 207-145(1)(d)
- ITAA 1997 207-145(1)(da)
- ITAA 1997 207-145(1)(db)
- ITAA 1997 207-145(1)(e)
- ITAA 1997 207-145(1)(f)
- ITAA 1997 207-157
- ITAA 1997 207-157(4)
- ITAA 1997 207-158(2)
- ITAA 1997 215-15
- ITAA 1997 Div 230
- ITAA 1997 Subdiv 974-C
- ITAA 1997 974-120
- ITAA 1997 995-1(1)
- Banking Act 1959 11AF
- Corporations Act 2001 Pt 6D.2

ATO references

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