

# ***CR 2024/27 - Insurance Australia Group Limited - IAG Capital Notes 3***

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## Class Ruling

# Insurance Australia Group Limited – IAG Capital Notes 3

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### **📌 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.

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### **What this Ruling is about**

1. This Ruling sets out the income tax consequences for entities who subscribed for and acquired Insurance Australia Group Limited Capital Notes 3 (IAG Capital Notes 3) issued by Insurance Australia Group Limited (IAG).
2. Details of this scheme are set out in paragraphs 39 to 70 of this Ruling.
3. In this Ruling, unless otherwise defined, capitalised terms have the meaning specified in the Terms of IAG Capital Notes 3 (the Terms), which are contained in Appendix A of the Replacement Prospectus for the issue of IAG Capital Notes 3 dated 12 March 2024 (the Prospectus), or in the glossary contained in Appendix B of the Prospectus.
4. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

**Note:** By issuing this Ruling, the ATO is not endorsing IAG Capital Notes 3. Potential investors must form their own view about IAG Capital Notes 3.

### **Who this Ruling applies to**

5. This Ruling applies to you if you are an investor who:
  - acquired your IAG Capital Notes 3 by initial application under the Prospectus

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- 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 IAG Capital Notes 3
- holds your IAG Capital Notes 3 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 IAG Capital Notes 3.

**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 (as defined in subsection 6(1) of the ITAA 1936) who holds their IAG Capital Notes 3 through a permanent establishment (as defined in subsection 6(1) of the ITAA 1936) in Australia
- the tax implications of Conversion of IAG Capital Notes 3 before the Mandatory Conversion Date on the occurrence of an Acquisition Event or a Non-Viability Trigger Event
- the tax implications of Redemption (other than for the application of sections 26BB, 45A, 45B and 70B of the ITAA 1936) or Resale of the IAG Capital Notes 3, and
- 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 2023 to 30 June 2034.

## **Ruling**

### **Consequences of acquiring Insurance Australia Group Limited Capital Notes 3**

#### ***Acquisition date***

8. You acquired your IAG Capital Notes 3 on 26 March 2024 under table item 2 of section 109-10.

### ***Insurance Australia Group Limited Capital Notes 3 are non-share equity interests***

9. Each of your IAG Capital Notes 3 is an 'equity interest' in IAG pursuant to Division 974 and is a 'non-share equity interest' in IAG as the term is defined in subsection 995-1(1).

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***Cost base and reduced cost base of Insurance Australia Group Limited Capital Notes 3***

10. The first element of the cost base and reduced cost base of each IAG Capital Note 3 is \$100, being the money you paid to acquire your IAG Capital Note 3 (subsections 110-25(2) and 110-55(2)).

***Consequences of holding Insurance Australia Group Limited Capital Notes 3***

***Distributions on Insurance Australia Group Limited Capital Notes 3 and entitlement to tax offset for franking credits***

11. A Distribution on an IAG Capital Note 3 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).

12. In the income year in which the Distribution is made you also:

- include the amount of the franking credit attached to a Distribution in your assessable income, and
- are entitled to a tax offset equal to the franking credit (section 207-20).

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).

14. 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).

***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.

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

16. 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.

***Gross-up and tax offset cancelled in certain circumstances***

17. 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.

18. You will be a qualified person in relation to a Distribution if, during the primary qualification period, you held your IAG Capital Notes 3 for a continuous period of at

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least 90 days during which you did not have 'materially diminished risks of loss or opportunities for gain' (as defined in former section 160APHM of the ITAA 1936) in respect of your IAG Capital Notes 3.

19. 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.

20. In respect of paragraphs 207-145(1)(b) and (c), refer to paragraphs 15 and 16 of this Ruling.

21. 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.

22. In respect of paragraph 207-145(1)(da), the distribution washing provision does not apply (refer to subparagraph 70(t) of this Ruling).

23. In respect of paragraph 207-145(1)(db), the IAG Capital Notes 3 are equity interests which form part of IAG's Additional Tier 1 Capital (refer to subsection 207-158(2) and subparagraph 70(c) of this Ruling).

### **Consequences of disposing of Insurance Australia Group Limited Capital Notes 3**

#### ***Insurance Australia Group Limited Capital Notes 3 are not traditional securities***

24. An IAG Capital Note 3 is not a 'traditional security' as defined in subsection 26BB(1) of the ITAA 1936.

25. Section 26BB of the ITAA 1936 will not apply to include any gain on the disposal or Redemption of an IAG Capital Note 3 in your assessable income.

26. Section 70B of the ITAA 1936 will not apply to allow you any loss on the disposal or Redemption of an IAG Capital Note 3 as a deduction.

27. The IAG Capital Notes 3 are not 'qualifying securities' within the meaning of subsection 159GP(1) of the ITAA1936.

### **Conversion of Insurance Australia Group Limited Capital Notes 3 for Ordinary Shares**

28. Each IAG Capital Note 3 is a convertible interest (being an interest of the kind referred to in table item 4 of subsection 974-75(1)).

29. CGT event C2 happens on Conversion (section 104-25).

30. A capital gain or capital loss you make from CGT event C2 happening on Conversion will be disregarded (subsection 130-60(3)).

31. Ordinary Shares acquired on Conversion will be taken to have been acquired when the Conversion happens on the relevant date of Conversion (subsection 130-60(2)).

32. The first element of the cost base and reduced cost base of Ordinary Shares acquired on Conversion will be equal to the cost base and reduced cost base of the relevant IAG Capital Notes 3 at the time of Conversion (table item 2 of subsection 130-60(1)).

33. As you hold your IAG Capital Notes 3 on capital account, no amount will be included in your assessable income on the Conversion of an IAG Capital Note 3 under section 6-5.

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34. In addition, you will not incur a deductible loss under section 8-1 as a consequence of Conversion of an IAG Capital Note 3.

35. On the Conversion of IAG Capital Notes 3 for Ordinary Shares, you will not be taken to have received a dividend or a non-share dividend.

### **Other integrity provisions**

#### **Section 45 of the ITAA 1936**

36. Section 45 of the ITAA 1936 will not apply to treat the Ordinary Shares issued on Conversion as an unfrankable dividend paid by IAG.

#### **Section 45A of the ITAA 1936**

37. 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 part of, a capital benefit that arises for you on Conversion or Redemption of the IAG Capital Notes 3 as an unfranked dividend.

#### **Section 45B of the ITAA 1936**

38. 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 part of, a capital benefit that arises for you on Conversion or Redemption of the IAG Capital Notes 3 as an unfranked dividend.

## **Scheme**

39. 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**

40. IAG is an Australian-incorporated company and is listed on the Australian Securities Exchange (ASX).

41. IAG is authorised as a non-operating holding company of general insurance companies under section 18 of the *Insurance Act 1973* and is subject to prudential supervision by the Australian Prudential Regulation Authority (APRA), which includes a requirement to maintain mandatory levels of Tier 1 Capital.

42. Under the Prospectus, IAG announced its intention to undertake a capital raising by the issue of IAG Capital Notes 3 for an issue price of \$100 each to raise \$350 million (with the ability to raise more or less) (the Offer).

43. The offer of IAG Capital Notes 3 was made to eligible clients of Syndicate Brokers and Institutional Investors wishing to make new investments in IAG Capital Notes 3. Applications under the offer were only accepted from investors who satisfied the eligibility requirements in accordance with the Target Market Determination.

44. The Issue Date for the IAG Capital Notes 3 was 26 March 2024.

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45. The IAG Capital Notes 3 are listed on the ASX under the ASX code IAGPF.
46. The IAG Capital Notes 3 were issued by IAG in Australia. The IAG Capital Notes 3 were not issued at or through an offshore permanent establishment or subsidiary of IAG.
47. The Offer is part of IAG's ongoing capital funding within its regulatory prudential capital requirements prescribed by APRA. IAG will use the proceeds of the Offer for general corporate purposes.

### **Main features of Insurance Australia Group Limited Capital Notes 3**

48. The IAG Capital Notes 3 are fully paid, mandatorily convertible, subordinated, perpetual debt securities issued by IAG.
49. A holder of IAG Capital Notes 3 (IAG Capital Note 3 Holder) does not have voting rights at a general meeting of IAG.

### **Issue price**

50. The Issue Price of each IAG Capital Note 3 is \$100. IAG Capital Notes 3 were fully paid on the Issue Date.

### **Distributions**

51. IAG will pay quarterly floating-rate cash Distributions in respect of each IAG Capital Note 3 on a Distribution Payment Date in accordance with the Terms.
52. The Distribution payable is calculated on the Issue Price of each IAG Capital Note 3 using a Distribution Rate, which is equal to the Bank Bill Rate plus a Margin adjusted by the Franking Adjustment Factor and based on the number of days in the Distribution Period. The Margin was determined in accordance with the Bookbuild.
53. The Distributions are expected to be franked at the same rate as dividends paid on Ordinary Shares. If the Distribution is not fully franked, then the Distribution will be a higher amount than otherwise, to reflect the applicable Franking Adjustment Factor.
54. The payment of a Distribution is subject to the sole discretion of IAG and will only be paid if a Payment Condition does not exist on the Distribution Payment Date. Broadly, a Payment Condition exists where IAG is prevented from paying the Distribution by prudential regulatory requirements, applicable law, or insolvency.
55. Distributions are non-cumulative and if all or any part of a Distribution is not paid, IAG Capital Note 3 Holders have no claim or entitlement in respect of such non-payment, and such non-payment does not constitute an event of default.
56. No interest accrues on any unpaid Distributions and IAG Capital Note 3 Holders have no claim or entitlement in respect of interest on any unpaid Distributions.
57. Subject to certain exceptions, if a Distribution is not paid in full on the Distribution Payment Date, IAG is restricted from declaring, paying or determining to pay an Ordinary Share Dividend, undertaking any buy-backs or capital reductions (unless IAG Capital Note 3 Holders approve by Special Resolution) until the next Distribution Payment Date. If the amount of any unpaid Distribution is paid in full within 3 Business Days of the Distribution Payment Date, this restriction will no longer apply.

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**Conversion**

58. Conversion of the IAG Capital Notes 3 involves each:
- IAG Capital Note 3 Holder being allotted and issued a number of Ordinary Shares for each IAG Capital Note 3 that is being Converted equal to the Conversion Number, and
  - IAG Capital Note 3 Holder's rights (including to payment of Redemption Price and Distributions, other than the Distribution, if any, payable on a date on which Conversion is required to occur that is not a Trigger Event Date) in relation to each IAG Capital Note 3 that is being Converted is immediately and irrevocably terminated for an amount equal to the Issue Price and IAG applies the Issue Price by way of payment for the subscription of the Conversion Number of Ordinary Shares to be issued on Conversion.
59. Upon Conversion of the IAG Capital Notes 3, all other rights conferred or restrictions imposed on each IAG Capital Note 3 under the Terms no longer have effect (except for rights relating to a Distribution which has been determined to be payable on a date of Conversion that is not a Trigger Event Date).
60. Each Ordinary Share issued upon Conversion ranks equally with all other Ordinary Shares.

**Mandatory conversion**

61. All outstanding IAG Capital Notes 3 must Convert into Ordinary Shares on the Mandatory Conversion Date.
62. The Mandatory Conversion Date is the first to occur of the following dates, on which the Mandatory Conversion Conditions are satisfied:
- 15 September 2033 (the Scheduled Mandatory Conversion Date), or
  - the first Distribution Payment Date after the Scheduled Mandatory Conversion Date on which those conditions are satisfied.

**Mandatory conversion on non-viability trigger event**

63. A Non-Viability Trigger Event occurs on the earlier of:
- the issuance to IAG of a written determination from APRA that conversion or write-off of Relevant Securities is necessary because, without it, APRA considers that IAG would become non-viable, or
  - a determination by APRA, notified to IAG in writing, that without a public sector injection of capital, or equivalent support, IAG would become non-viable.
64. A Conversion following a Non-Viability Trigger Event will occur immediately and is not subject to any conditions. The number of Ordinary Shares that IAG Capital Note 3 Holders receive on a Conversion will not be greater than the Maximum Conversion Number. If the Notes are not Converted within 5 Business Days after the relevant Trigger Event Date for any reason they will be Written-Off, which means that all rights in relation to those Notes will be terminated, and those IAG Capital Note 3 Holders will not get their capital repaid or receive compensation.



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**Mandatory conversion on acquisition event**

65. An Acquisition Event occurs where more than 50% of IAG's Ordinary Shares are acquired by a person as a result of a takeover bid or a scheme of arrangement.

66. If an Acquisition Event occurs, IAG must convert all (but not some only) IAG Capital Notes 3 on the Acquisition Conversion Date.

**Optional exchange**

67. On an Optional Exchange Date (being 15 December 2030, 15 March 2031, 15 June 2031 or 15 September 2031), IAG may choose to:

- Convert each IAG Capital Note 3 into Ordinary Shares
- Redeem each IAG Capital Note 3 by paying an IAG Capital Note 3 Holder a cash amount equal to the Issue Price (\$100) of each IAG Capital Note 3 and upon payment by IAG, all other rights conferred, or restrictions imposed, by the IAG Capital Note 3 will no longer have effect, or
- Resell each IAG Capital Note 3 to one or more Nominated Purchaser for the Resale Price, being a cash amount equal to the Issue Price (\$100) of each IAG Capital Note 3.

68. IAG must obtain APRA's written approval and specify which of the methods or combination of methods mentioned in paragraph 67 of this Ruling it will use to exchange IAG Capital Notes 3.

69. An IAG Capital Note 3 Holder does not have a right to request Conversion, Redemption or Resale of the IAG Capital Notes 3.

**Other matters**

70. This Ruling is made on the basis that:

- (a) During the term of the scheme, IAG is a resident of Australia under the income tax laws of Australia and of no other jurisdiction.
- (b) The majority of the IAG Capital Note 3 Holders who acquire the IAG Capital Notes 3 under the Offer are expected to be residents of Australia for tax purposes, although some may be non-residents.
- (c) The IAG Capital Notes 3 form part of IAG's Additional Tier 1 Capital for the purposes of the prudential standards determined by APRA under section 32 of the *Insurance Act 1973*.
- (d) The Distributions are frankable distributions under section 202-40.
- (e) In accordance with Division 203, IAG will frank Distributions in respect of the IAG Capital Notes 3 at the same franking percentage as the IAG benchmark for the franking period in which the frankable distribution is made.
- (f) Distributions on the IAG Capital Notes 3 are not sourced, directly or indirectly, from IAG's share capital account or its non-share capital account.
- (g) Distributions paid on the IAG Capital Notes 3 will not be debited to IAG's share capital account or its non-share capital account.

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- (h) Immediately before the payment of a Distribution on the IAG Capital Notes 3, IAG has available frankable profits (worked out under section 215-20) at least equal to the Distribution.
- (i) IAG expects to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account).
- (j) IAG does not differentially frank Distributions to different IAG Capital Note 3 Holders according to their tax status or on any other basis.
- (k) The dividend payout ratios and IAG's policies in relation to the franking of its distributions on its Ordinary Shares and other equity instruments of IAG (to the extent such dividends / distributions are frankable) are not expected to change as a result of the issue of the IAG Capital Notes 3, other than to comply with the dividend / distribution restrictions in the Terms.
- (l) The share capital account of IAG does not become tainted (within the meaning of Division 197) by the issue of the IAG Capital Notes 3 or the allotment of Ordinary Shares on Conversion of the IAG Capital Notes 3.
- (m) On Conversion or Redemption of the IAG Capital Notes 3, IAG debits the Issue Price of the IAG Capital Notes 3 to its non-share capital account.
- (n) Ordinary Shares issued to the IAG Capital Notes 3 Holders on Conversion of the IAG Capital Notes 3 are equity interests under Division 974.
- (o) The accounts of the IAG group are prepared in accordance with the applicable accounting standards.
- (p) All parties to the scheme are dealing with each other at arm's length.
- (q) You (or an associate) will not take any 'positions' (as defined in former section 160APHJ of the ITAA 1936) at any time in relation to your IAG Capital Notes 3 apart from holding your IAG Capital Notes 3.
- (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 IAG Capital Notes 3 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)).

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**Commissioner of Taxation**

24 April 2024

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## Appendix – Explanation

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**ⓘ** *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.*

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

71. 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.

72. Based on the scheme, there is no evidence of streaming. Distributions will be received by all IAG Capital Note 3 Holders by reason of their proportionate holding of IAG Capital Notes 3 and not by reference to their tax profiles or individual tax positions. There is nothing in the Terms that allows IAG to treat the IAG Capital Note 3 Holders differently in respect of their entitlement to a franked Distribution.

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

73. 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.

74. The conditions in paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are 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 an incidental purpose of enabling an IAG Capital Note 3 Holder to obtain an imputation benefit (refer paragraph 177EA(3)(e) of the ITAA 1936).

75. The Commissioner considers that the relevant circumstances of the scheme do not, on balance, lead to a conclusion that the purpose of enabling IAG Capital Note 3 Holders to obtain imputation benefits is more than incidental to IAG's primary purpose of raising Additional Tier 1 capital for regulatory capital requirements and otherwise to maintain the diversity of its sources and types of funding.

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**Gross-up and tax offset cancelled in certain circumstances**

76. 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)).

77. As this Ruling is made on the basis that you (or an associate) 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 acquire your IAG Capital Notes 3 and ends on the 90th day after the day IAG Capital Notes 3 becomes ex-distribution.

78. You need to have held your IAG Capital Notes 3 '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).

79. 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 IAG Capital Notes 3 if your net position on that day does not retain 30% or more of the risks and opportunities associated with holding IAG Capital Notes 3.

80. Embedded options such as Resale and Conversion do not represent separate positions in relation to IAG Capital Notes 3 (see also Taxation Determination TD 2007/29 *Income tax: holding period rule: is an embedded share option a position in relation to the share if it is exercisable by or against a party other than the issuer of the share?*). Under a Resale, you will only be taken to have made an offer to sell IAG Capital Notes 3 if IAG issues a Resale Notice. As IAG is the only party entitled to make an election to exercise the Resale option, it is not a separate position that you have taken in relation to your IAG Capital Notes 3. Similarly, under Conversion you do not have the right to elect Conversion of your IAG Capital Notes 3 and neither does IAG have an obligation to Convert.

81. Therefore, Resale and Conversion will not, of themselves, affect your risks of loss or opportunities for gain in respect of your IAG Capital Notes 3.

82. However, if you do enter into any risk management strategies in respect of your IAG Capital Notes 3 that have the effect of reducing your risks of loss and opportunities for gain below 30% (for example, by the use of limited recourse loans, options or other derivatives), then you will not be considered a qualified person in respect of a Distribution.

**Conversion of Insurance Australia Group Limited Capital Notes 3 for Ordinary Shares**

83. The issue of Ordinary Shares to IAG Capital Note 3 Holders on Conversion is a distribution of property made to holders of non-share equity interests and a non-share distribution under subparagraph 974-115(b)(ii). A non-share distribution is a non-share dividend under subsection 974-120(1), subject to the application of subsection 974-120(2).

84. Subsection 974-120(2) provides that a non-share distribution is not a non-share dividend to the extent to which the company debits the distribution against the company's share capital account or non-share capital account.

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85. On Conversion, IAG will debit the Issue Price of each IAG Capital Note 3 to its non-share capital account. Accordingly, the issue of Ordinary Shares on Conversion will not be a non-share dividend and will not be included in your assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

86. Furthermore, the Ordinary Shares will not be issued to the IAG Capital Note 3 Holders as shareholders of IAG. Accordingly, the issue of the Ordinary Shares will not satisfy paragraphs (a) or (b) of the definition of dividend in subsection 6(1) of the ITAA 1936. This means that it will not be included in your assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

### **Section 45 of the ITAA 1936**

87. 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 but not all shareholders, and
- some or all of the shareholders who do not receive the shares receive or will receive minimally franked dividends.

88. IAG's payout ratios in relation to its Ordinary Shares and other equity interests are not expected to change as a result of issuing IAG Capital Notes 3. The extent to which IAG's distributions / dividends will be franked (including Distributions on IAG Capital Notes 3) will depend on a number of factors, including the IAG group's capital management activities and the level of profits generated by the group that will be subject to tax in Australia.

89. Under the Terms, IAG is unable to issue Ordinary Shares to all or some IAG Capital Note 3 Holders in satisfaction of their Distribution entitlement under IAG Capital Notes 3. The issue of Ordinary Shares on Conversion merely reflects a change in the type of equity interests held by IAG Capital Note 3 Holders in IAG.

90. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to treat the value of Ordinary Shares issued to you on Conversion as an unfrankable dividend.

### **Section 45A of the ITAA 1936**

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

92. Both the issue of Ordinary Shares on Conversion and the Redemption of IAG Capital Notes 3 will constitute the provision of a capital benefit to IAG Capital Note 3 Holders (paragraph 45A(3)(a) of the ITAA 1936 for a Conversion, and paragraph 45A(3)(b) of the ITAA 1936 as affected by subsection 45A(3A) of the ITAA 1936 for a Redemption).

93. However, the issue of Ordinary Shares on Conversion and the Redemption of IAG Capital Notes 3 will not constitute the streaming of capital benefits because under a Conversion or Redemption, IAG will not selectively direct the flow of capital benefits to IAG Capital Note 3 Holders who could most benefit from the receipt of capital. Accordingly, as this requirement does not apply to the Conversion or Redemption of IAG Capital Notes 3,

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the Commissioner will not make a determination to treat the whole or a part of the capital benefit received by you as an unfranked dividend.

#### **Section 45B of the ITAA 1936**

94. 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.

95. The issue of Ordinary Shares to IAG Capital Note 3 Holders on Conversion and the Redemption of IAG Capital Notes 3 will each constitute a scheme under which IAG Capital Note 3 Holders are provided with a capital benefit by IAG (paragraphs 45B(5)(a) and (b) and subsection 45B(7) of the ITAA 1936). As a result, paragraph 45B(2)(a) of the ITAA 1936 will be satisfied.

96. At least some IAG Capital Note 3 Holders will obtain a tax benefit as defined in subsection 45B(9) of the ITAA 1936 as a result of a Conversion or Redemption. As a result, paragraph 45B(2)(b) of the ITAA 1936 will be satisfied.

97. Therefore, whether section 45B of the ITAA 1936 will apply to a Conversion or Redemption turns on whether paragraph 45B(2)(c) of the ITAA 1936 will be satisfied. This involves considering the relevant circumstances, including but not limited to those listed in subsection 45B(8) of the ITAA 1936, of the Conversion and Redemption schemes to establish whether one of the persons who will enter into or carry out the schemes will do so for a more than incidental purpose of enabling a relevant taxpayer (the IAG Capital Note 3 Holder) to obtain a tax benefit.

98. Having regard to the relevant circumstances, it could not be concluded that the Conversion or Redemption of IAG Capital Notes 3 will be entered into for a more than incidental purpose of enabling IAG Capital Note 3 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 you on Conversion or Redemption.

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Status: **not legally binding**

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TD 2007/29

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