CR 2006/87 - Income tax: Westpac Funds Management Limited, Westpac Banking Corporation - Westpac Trust Preferred Securities (Westpac TPS)

Class Ruling

Income tax: Westpac Funds Management Limited, Westpac Banking Corporation – Westpac Trust Preferred Securities (Westpac TPS)

Contents Para

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 (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and 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 provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The provisions dealt with in this Ruling are:

- Division 1A of Part IIIAA of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 177EA of the ITAA 1936;
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 202-5 of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 202-45 of the ITAA 1997;
- section 204-30 of the ITAA 1997;

- Subdivision 207-B of the ITAA 1997;
- Subdivision 207-F of the ITAA 1997; and
- Division 974 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the Australian resident individuals, companies and complying superannuation entities (referred to as 'Westpac TPS Holders') who subscribe for and are allotted Westpac TPS by Westpac Funds Management Limited, the responsible entity of the Westpac Trust Preferred Securities Trust (Westpac TPS Trust).

4. The class of entities to which this Ruling applies does not include investors who acquire the Westpac TPS otherwise than by subscription. The Ruling does not address how the taxation provisions apply to Westpac Banking Corporation (Westpac) or Westpac Funds Management Limited.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

6. 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 14 to 56 of this Ruling.

7. 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.

Date of effect

9. This Ruling applies from 6 September 2006. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

13. The Ruling is withdrawn and ceases to have effect after 30 June 2009. However, the Ruling continues to apply after its withdrawal in respect of the relevant provisions ruled upon, to all persons within the specified class who entered into the specified arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Scheme

14. The scheme that is the subject of this Ruling is described below. The description incorporates the following documents:

- application for a Class Ruling dated 24 March 2006 received from Allens Arthur Robinson on behalf of Westpac;
- Westpac Trust Preferred Securities Product Disclosure Statement dated 19 May 2006;

- Undertaking Deed (incorporating Preference Share Terms) dated 10 May 2006;
- Note Deed (incorporating Note Terms) dated 10 May 2006;
- Constitution of the Westpac TPS Trust (incorporating Westpac TPS Terms and Ordinary Unit Terms) dated 8 August 2005. Consolidated version of Constitution dated 19 May 2006 as amended by Supplemental Deed dated 26 April 2006, Second Supplemental Deed dated 10 May 2006 and Third Supplemental; and
- Payment Settlement Deed dated 10 May 2006.

Note: Certain information which relates to the affairs of Westpac that is not in the public domain has been taken into account in determining the Commissioner's opinion set out in this Ruling (including the application of certain anti-avoidance provisions). This information has been provided on a commercial-in-confidence basis and will not be released under the Freedom of Information legislation.

15. In this Ruling unless otherwise defined, capitalised terms take their meaning as per the Westpac TPS Product Disclosure Statement (PDS).

16. The Westpac TPS are units in the Westpac TPS Trust, which is a registered managed investment scheme. Westpac Funds Management Limited (Issuer) is the responsible entity of the Westpac TPS Trust and issued the Westpac TPS to investors.

17. The Offer period for the Westpac TPS commenced on 19 May 2006 and closed on 13 June 2006 for Securityholders and 19 June 2006 for Broker Firm applicants. Investors subscribed for Westpac TPS pursuant to the PDS dated 19 May 2006.

18. The Westpac TPS were allotted on 21 June 2006. The Issuer raised approximately $762 million from the issue.

19. The Westpac TPS were issued at an issue price of $100 subject to a minimum Application amount of 50 Westpac TPS (or $5,000).

20. Westpac TPS are listed on the Australian Stock Exchange.

21. Subject to a Distribution Payment Test, Westpac TPS Holders are scheduled to receive non-cumulative, quarterly Distributions of trust income at a pre-determined Distribution Rate. Distributions on the Westpac TPS are expected to be fully franked.

22. The amount of the Distribution for a Distribution Period is calculated as follows:

Distribution = ((Distribution Rate × Issue Price × days in Distribution Period)/365)

23. The Distribution Rate will be set on the first business day of each Distribution Period by applying a Margin of 1.00% per annum to the average mid-rate for 90 day bank bills (expressed as a percentage per annum) which average rate is displayed on Reuters page BBSW (or any page that replaces that page) on that date and multiplying the sum by (1 - Australian corporate Tax Rate). This is represented by the following formula:

Distribution Rate = (BBSW + Margin) × (1 - Australian corporate tax rate)

24. There will be a step-up in the Margin used to calculate the Distribution Rate by 1% per year starting from the first Distribution Payment Date occurring after 30 June 2016 (Step-up Date).

25. To the extent that Distributions on the Westpac TPS do not carry franking credits (otherwise than because of any act by, or circumstance affecting any particular Westpac TPS Holder), the Distribution will be increased by a cash amount to compensate for the unfranked amount of the Distribution. Such a payment is subject to the Distribution Payment Test.

26. The Distribution Payment Test will be satisfied if:

- (i) the Westpac TPS Trust has received sufficient Trust Income in respect of the relevant Distribution Period;
- (ii) the Westpac Directors, in their discretion, have resolved that a Distribution is payable and Westpac has notified the Issuer of that resolution;
- (iii) unless the Australian Prudential Regulation Authority (APRA) gives its prior approval, the amount of the Distribution does not exceed the Distributable Profits of the Westpac group; and
- (iv) APRA does not otherwise object to the payment, or in the case of an Optional Distribution, has given its prior approval.

27. If all or part of a Distribution is not paid, the Issuer will have no obligation to pay, and Westpac TPS Holders will have no right to be paid, the unpaid Distribution. The Issuer may, however, make an Optional Distribution equal to all or part of the unpaid amount.

28. If any Distribution is not paid on the Westpac TPS, in full, within 20 business days of a Distribution Payment Date, Westpac is subject to a capital and dividend Stopper. The effect of the capital and dividend Stopper is that, subject to obtaining approval by Special Resolution of Westpac TPS Holders, Westpac is generally restricted from declaring or paying any interest, dividends or making any income distributions on any Capital Securities which rank equally or are junior to the Notes (refer to paragraph 37 of this Ruling) in respect of those payments or from redeeming, reducing, cancelling or acquiring any Capital Securities (other than Capital Securities which rank equally with or ahead of the Notes for a return of Capital in a winding-up of Westpac), unless and until:

- (i) the Westpac TPS Holders have been paid, in full, the next four consecutive Distributions which are scheduled to be paid after the Distribution Payment Date for the Distribution that has not been paid in full;
- (ii) an Optional Distribution has been paid, with APRA approval, equal to the amount of any unpaid Distributions scheduled to be paid in the preceding 12 months before the date of the Optional Distribution;

(iii) all Westpac TPS are Redeemed, Converted or Exchanged; or

(iv) a Special Resolution of the Westpac TPS Holders has been passed approving such action.

29. The Westpac TPS carry rights to vote in relation to the Westpac TPS Trust.

30. The Westpac TPS are not Redeemable, Convertible or Exchangeable at the instigation of the Westpac TPS Holders.

31. The Issuer must elect (if Westpac resolves to require the Issuer to do so) to Redeem some or all the Westpac TPS for their Issue Price or Convert some or all of the Westpac TPS into Ordinary Shares in Westpac, with APRA's prior approval, if required, by giving an Issuer Notice to the Westpac TPS Holders, in the following circumstances:

(i) on the Step-up Date or any Distribution Payment Date after the Step-up Date;

(ii) upon the occurrence of certain Tax Events (relating to changes in the Australian or New Zealand tax laws);

(iii) upon the occurrence of certain Regulatory Events (relating to classification of certain securities for APRA purposes); and

(iv) upon the occurrence of certain Acquisition Events (relating to takeovers).

32. The Issuer must elect (if Westpac resolves to require the Issuer to do so) to Redeem all the Westpac TPS for their Issue Price or Convert all of the Westpac TPS into Ordinary Shares in Westpac, with APRA's prior approval if required, by giving notice to the Westpac TPS Holders in the following circumstances:

(i) upon the occurrence of certain Trust Events (relating to a change of the responsible entity or the winding up of the Westpac TPS Trust or the inability of the Issuer to redeem the Westpac TPS); or

(ii) if the aggregate issue price of the Westpac TPS on issue is less than $50 million.

33. If the Westpac TPS are Converted to Ordinary Shares in Westpac, the Westpac TPS will be Redeemed for their Redemption Price of $100 and the Redemption Price will be applied in payment of the Ordinary Share Issue Price. A Westpac TPS Holder is entitled to receive the number of Westpac Ordinary Shares equal to the lesser of 50 (being the maximum conversion number (subject to certain adjustments contained in the Westpac TPS terms of issue)) or a number of Westpac Ordinary Shares calculated in accordance with the Westpac TPS terms of issue.

34. The Issuer must Exchange all of the Westpac TPS for Preference Shares issued by Westpac upon the occurrence of any of the following events (Automatic Exchange Event):

- an Event of Default (relating to Westpac ceasing or suspending all of its business, or the commencement of proceedings to dissolve or wind up Westpac, or the appointment of a liquidator/administrator, or Westpac making payments in breach of the capital and dividend Stopper);
- certain APRA Events (relating to APRA making certain determinations or directions, or Westpac's retained earnings falling below zero); or
- 30 September 2055.

35. If an Automatic Exchange Event occurs, the Westpac TPS will be Redeemed for their Redemption Price and the Redemption Price will be applied in payment of the Preference Share Issue Price. A Westpac TPS with an issue price of $100 will exchange into one Westpac Preference Share with an issue price of $100.

36. Westpac holds one nominal Ordinary Unit in the Westpac TPS Trust. The Ordinary Unit will confer upon Westpac a vested and indefeasible interest in any residual income of the Westpac TPS Trust but no right to have the Ordinary Unit redeemed for shares in Westpac.

37. All proceeds from the issue of the Westpac TPS were applied by the Issuer to subscribe for convertible notes (Notes) issued by Westpac.

38. The Notes are unlisted, perpetual securities with an issue price of $100 per Note.

39. Subject to a payment test (Interest Payment Test), the Notes will pay quarterly, cumulative interest payments (Interest Payments). Interest will not accrue on accumulated amounts. Interest Payments on the Notes are expected to be fully franked.

40. The amount of the Interest Payment for each period (Interest Period) is calculated in accordance with the following formula:

$$\text{Interest Payment} = \text{Interest Rate} \times \text{issue price} \times (\text{days in period}/365)$$

41. The Interest Rate will be set on the first business day of each Interest Period by applying a margin (Note Margin) per annum to the average mid-rate for 90 day bank bills (expressed as a percentage per annum) which average rate is displayed on the Reuters page BBSW on that date. This is represented by the following formula:

$$\text{Interest Rate} = (\text{BBSW} + \text{Note Margin})$$

42. There will be a step-up in the Note Margin used to calculate the Interest Rate by 1% per year starting from the first Interest Payment date occurring after 30 June 2016 (Step-up Date).

43. To the extent that the Interest Payments are not fully franked, or, despite being franked, if the franking credit benefits would not pass through the Westpac TPS Trust to the Westpac TPS Holders (otherwise than because of any act by, or circumstance affecting any particular Westpac TPS Holder), the Interest Payments will be increased by a cash amount to compensate for the unfranked amount. Such a payment is subject to the Interest Payment Test.

44. The Interest Payment Test will be satisfied if:

(i) the Directors of Westpac, at their discretion, have resolved that the Interest Payments or accumulated interest payments are to be paid;

(ii) unless APRA gives its prior approval, the amount of the Interest Payment, or accumulated interest payments does not exceed the Distributable Profits of the Westpac group; and

(iii) APRA does not otherwise object to the payment or, in the case of accumulated interest, APRA has given its prior approval to the payment.

45. The Notes will not be Redeemable, Convertible or Exchangeable at the instigation of the Issuer of the Westpac TPS Trust (as holder of the Notes).

46. Westpac may choose to Redeem some or all of the Notes for their issue price or Convert the Notes into Ordinary Shares in Westpac, by giving notice to the Note holder, in the following circumstances:

(i) on the Step-up Date or any Interest Payment Date after the Step-up Date;

(ii) upon the occurrence of certain Tax Events (relating to changes in the Australian or New Zealand tax laws);

(iii) upon the occurrence of certain Regulatory Events (relating to classification of certain securities for APRA purposes); or

(iv) upon the occurrence of certain Acquisition Events (relating to takeovers).

47. Westpac may elect to Redeem all of the Notes for their Issue Price or Convert all of the Notes into Ordinary Shares in Westpac, with APRA's prior approval if required, by giving notice to the Note holder in the following circumstances:

(i) upon the occurrence of certain Trust Events (relating to a change of the responsible entity or the winding up of the Westpac TPS Trust or the inability of the Issuer to redeem the Westpac TPS); or

(ii) if the aggregate issue price of the Westpac TPS on issue is less than $50 million.

48. If the Notes are Converted into Westpac Ordinary Shares, the Notes will be Redeemed by Westpac for their Redemption Amount of $100 and the Redemption Amount will be applied in payment of the Westpac Ordinary Share Issue Price. The Ordinary Shares in Westpac will be issued by Westpac to the Westpac TPS Holders.

49. Westpac must Exchange all of the Notes for Preference Shares issued by Westpac upon the occurrence of any of the following events (Automatic Exchange Event):

- (i) an Event of Default (relating to Westpac ceasing or suspending all of its business, or the commencement of proceedings to dissolve or wind up Westpac, or the appointment of a liquidator/administrator or Westpac making payments in breach of the capital and dividend Stopper);
- (ii) certain APRA Events (relating to APRA making certain determinations or directions, or Westpac's retained earnings falling below Zero); or
- (iii) 30 September 2055.

50. If the Notes are Exchanged for Westpac Preference Shares the Notes will be Redeemed by Westpac for their Redemption Amount of $100 and the Redemption Amount will be applied in payment of the issue price of the Westpac Preference Shares. The Westpac Preference Shares will be issued by Westpac to the Westpac TPS Holders.

51. The effect of the Redemption, Exchange or Conversion terms of the Westpac TPS and the Notes is that if a Redemption, Exchange or Conversion of the Westpac TPS occurs, the Notes will be Redeemed, Exchanged or Converted by Westpac simultaneously.

52. Westpac advises that it expects to fully frank all frankable distributions made by it.

53. Westpac has been given approval from APRA that the Westpac TPS will qualify as Tier 1 regulatory capital.

54. Westpac advises that the proceeds from the issue of the Notes will be used in the ordinary business operations of Westpac's New Zealand branch.

55. Westpac advises that the cost of raising capital in this manner will be less than the cost to Westpac of issuing additional ordinary shares and will be more readily redeemable by Westpac than ordinary shares would be.

Assumptions

56. This Ruling is made on the basis that:

(i) during the term of the scheme, Westpac and the Westpac TPS Trust will be Australian residents under the income tax laws of Australia and no other jurisdiction;

(ii) Interest Payments on the Notes will not be debited against a disqualifying account of Westpac;

(iii) Westpac will have a zero balance in its disqualifying account when making payments on the Notes;

(iv) all of the income of the Westpac TPS Trust will be sourced from the Interest paid by Westpac on the Notes;

(v) to the extent that the Interest paid on the Notes is a non-share dividend, that distribution is expected to be fully franked;

(vi) immediately before the payment of a non-share dividend Westpac will have available frankable profits to pay the non-share dividend at least equal to the amount of the franked distribution;

(vii) the terms and conditions under which the Notes were originally issued will not be altered in any material way during the period to which this Ruling applies;

(viii) throughout the period to which this Ruling applies, the material supplied to the Commissioner, and taken into account in determining the application of the taxation provisions discussed in this Ruling, remain an accurate description of all of the activities of Westpac, the Westpac TPS Trust and any other members of Westpac that are a material or relevant consideration in respect of any of those taxation provisions;

(ix) the Issuer will be a qualified person (within the meaning of subsection 995-1(1) of the ITAA 1997) in relation to any Interest Payments received on the Notes;

(x) Westpac TPS Holders will not have any positions (within the meaning of section 160APHJ of the ITAA 1936) in relation to the Notes apart from holding the Westpac TPS themselves;

(xi) Westpac TPS Holders, or their associates, will not make any related payments (within the meaning of section 160APHN of the ITAA 1936) in relation to the Interest Payments on the Notes; and

(xii) Westpac TPS Holders will not dispose of their Westpac TPS before a period of at least 90 days (excluding the date of acquisition and disposal) beginning the day after allotment of the Westpac TPS.

Ruling

Interest Payments paid to the Westpac TPS Trust on the Notes are non-share dividends and may be franked

57. On the basis of the information provided, and having regard to the assumptions and qualifications set out in this Ruling:

- the Notes issued to the Westpac TPS Trust by Westpac will be equity interests for the purposes of Division 974 of the ITAA 1997;
- Interest Payments on the Notes made by Westpac to the Westpac TPS Trust will constitute non-share dividends pursuant to section 974-120 of the ITAA 1997, provided that the distributions are not debited to Westpac's share capital account; and
- the non-share dividend is a frankable distribution pursuant to subsection 202-40(2) of the ITAA 1997.

58. Where Westpac franks a non-share dividend, paid on the Notes to the Westpac TPS Trust, in accordance with section 202-5 of the ITAA 1997, the non-share dividend will be a franked distribution.

Franked distributions flow indirectly to the Westpac TPS Holders

59. For the purposes of section 207-50 of the ITAA 1997, any franked distribution made by Westpac to the Westpac TPS Trust will flow indirectly to the Westpac TPS Holders.

The Westpac TPS Holders include the Distributions and franking credits in their assessable income

60. In addition to including in the assessable income of the Westpac TPS Holder an amount attributable to their share of the franked distribution received from the Westpac TPS Trust, an amount attributable to the Westpac TPS Holder's share of the franking credit on the franked distribution will also be included in their assessable income under subsection 207-35(3) of the ITAA 1997.

Tax offset

61. Where franked distributions, paid to the Westpac TPS Trust, flow indirectly to Westpac TPS Holders who are individual Investors, corporate Investors, or trustee Investors (as specified in paragraphs 207-45(c) or (d) of the ITAA 1997), and the whole or part of the franked distributions are included in their assessable income along with an amount equal to their share of the franking credits attached to the franked distributions, then pursuant to section 207-45 of the ITAA 1997, the Westpac TPS Holder is entitled to a tax offset equal to the Westpac TPS Holder's share of the franking credit attached to the franked distribution.

Refundable tax offset

62. Westpac TPS Holders, that are not subject to the exclusions contained in subsections 67-25(1A) to (1D) of the ITAA 1997 will be recipients of refundable tax offsets and will be entitled to a refund of those tax offsets to the extent that they exceed the Westpac TPS Holder's liability to tax that would have arisen in the absence of their entitlement to the refundable tax offset, provided that none of sections 207-120, 207-122, 207-124 or 207-126 of the ITAA 1997 are applicable.

Qualified person

63. Each Westpac TPS Holder will be taken to be a 'qualified person', for the purposes of Division 1A of Part IIIAA of the ITAA 1936, in respect of the franked distributions paid to the Westpac TPS Trust.

The anti-avoidance provisions

Section 177EA of the ITAA 1936

64. It is not considered appropriate for the Commissioner to make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by the Westpac TPS Holders.

Section 204-30 of the ITAA 1997

65. Section 204-30 of the ITAA 1997 will not apply to deny the whole, or any part, of the imputation benefits received by the Westpac TPS Holders.

Commissioner of Taxation
6 September 2006

Appendix 1 – Explanation

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.

Interest Payments paid to the Westpac TPS Trust on the Notes are non-share dividends and may be franked

66. On the basis of the information provided, and having regard to the assumptions and qualifications set out in this Ruling, the Notes issued to the Westpac TPS Trust by Westpac satisfy the basic test for an equity interest contained in subsection 974-75(1) of the ITAA 1997. The Notes are not characterised as, and do not form part of a larger interest that is characterised as, a debt interest in Westpac or a connected entity of Westpac, under Subdivision 974-B of the ITAA 1997. Accordingly, the Notes will be characterised as non-share equity interests pursuant to the definition of that term in subsection 995-1(1) of the ITAA 1997.

67. The Interest Payments on the Notes by Westpac to the TPS Trust will be a non-share distribution under section 974-115 of the ITAA 1997. Provided that the distribution is not debited to Westpac's non-share capital account or Westpac's capital account, the distribution will constitute a non-share dividend pursuant to section 974-120 of the ITAA 1997.

68. Subsection 202-40(2) of the ITAA 1997 provides that a non-share dividend is a frankable distribution to the extent that it is not made unfrankable under section 202-45 of the ITAA 1997. None of paragraphs 202-45(a) to 202-45(j) of the ITAA 1997 apply. Accordingly the non-share dividend is a frankable distribution.

69. Where Westpac franks a non-share dividend, paid on the Notes to the Westpac TPS Trust in accordance with section 202-5 of the ITAA 1997, the non-share dividend will be a franked distribution.

Franked distributions flow indirectly to the Westpac TPS Holders

70. In general terms, pursuant to subsection 207-50(3) of the ITAA 1997, a franked distribution will flow indirectly to a beneficiary of a trust where:

(i) the distribution is made to, or flows indirectly to, the trustee;

(ii) the beneficiary has a share, or an individual interest in the trust's net income; and

(iii) the beneficiary's share of the distribution, as determined by section 207-55 of the ITAA 1997, is a positive amount.

71. The beneficiary's share of the franking credit on the franked distribution will be determined by section 207-57 of the ITAA 1997.

72. Consequently, a franked distribution made to the Westpac TPS Trust is treated as flowing indirectly to the Westpac TPS Holders pursuant to subsection 207-50(3) of the ITAA 1997.

The Westpac TPS Holders include the distributions and franking credits in their assessable income

73. On the basis of information provided, and having regard to the assumptions and qualifications set out in this Ruling, an amount equal to the amount of the franking credits on the franked distributions paid in respect of the Notes will be included in the assessable income of the Westpac TPS Trust pursuant to subsection 207-35(1) of the ITAA 1997.

74. Westpac TPS Holders will have an amount of assessable income for an income year that is attributable to the whole or part of the franked distributions received in that year. Therefore, under subsection 207-35(3) of the ITAA 1997, Westpac TPS Holders will include in their assessable income so much of the franking credits as is equal to their share of the franking credits on the franked distributions paid to the Westpac TPS Trust on the Notes.

Tax offset

75. Where franked distributions, paid to the Westpac TPS Trust, flow indirectly to Westpac TPS Holders who are individual Investors, corporate Investors, or trustee Investors (as specified in paragraphs 207-45(c) or (d) of the ITAA 1997), and the whole or part of the franked distributions are included in their assessable income along with an amount equal to their share of the franking credits attached to the franked distributions, then pursuant to section 207-45 of the ITAA 1997, the Westpac TPS Holder is entitled to a tax offset equal to the Westpac TPS Holder's share of the franking credit attached to the franked distribution.

Refundable tax offset

76. The franking credit on the distribution will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided the Westpac TPS Holders are not excluded by subsections 67-25(1A) to (1D) of the ITAA 1997. Those exclusions apply to certain trustees (of non-complying superannuation funds or non-complying approved deposit funds, and trustees liable to be assessed under sections 98, 99 or 99A of the ITAA 1936) and corporate tax entities (not including exempt institutions eligible for a refund or life insurance companies in some circumstances). In addition, Westpac TPS Holders that are exempt institutions that are eligible for refundable tax offsets may be denied those tax offsets where they come within the exceptions set out in sections 207-120, 207-122, 207-124 or 207-126 of the ITAA 1997.

77. Westpac TPS Holders, that are not subject to the exclusions contained in subsections 67-25(1A) to (1D) of the ITAA 1997 will be recipients of refundable tax offsets and will be entitled to a refund of those tax offsets to the extent that they exceed the Westpac TPS Holder's liability to tax that would have arisen in the absence of their entitlement to the refundable tax offset, provided that none of sections 207-120, 207-122, 207-124 or 207-126 of the ITAA 1997 are applicable.

Gross-up and tax offset denied in certain circumstances

78. Pursuant to Subdivision 207-F of the ITAA 1997 the gross-up and tax offset are denied in the circumstances set out in section 207-150 of the ITAA 1997. These circumstances include the following:

- (i) the Westpac TPS Holder is not a qualified person in relation to the franked distributions paid on the Notes for the purposes of Division 1A of Part IIIAA of the ITAA 1936 ('the holding period rules');
- (ii) the Commissioner has made a determination under subsection 204-30(3) of the ITAA 1997 that no imputation benefits are to arise for the receiving entity in respect of the franked distributions; and
- (iii) the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefits are to arise in respect of the franked distributions.

Qualified person

79. The recipient of a franked distribution that is a non-share distribution must be a qualified person in relation to that non-share distribution. A 'qualified person' is defined in subsection 995-1(1) of the ITAA 1997 by reference to the holding period rules as in force on 30 June 2002. By virtue of section 160AOA of the ITAA 1936, the holding period rules apply to non-share equity interests, equity holders and non-share dividends in the same way as they apply to shares, shareholders and dividends respectively.

80. A beneficiary of a trust can be a qualified person in relation to a dividend (or franked distribution) only if the trustee of the trust is also a qualified person. On the basis of the information provided, and having regard to the assumptions and qualifications set out in this Ruling, the Issuer (as trustee of the Westpac TPS Trust) is a qualified person in relation to the non-share distributions paid in respect of the Notes.

81. Division 1A of Part IIIAA of the ITAA 1936 sets out the circumstances in which a taxpayer will be a qualified person in respect of dividends paid on shares. Under section 160APHO of the ITAA 1936 a taxpayer will be a qualified person if the relevant interest in the shares are held 'at risk' during the relevant 'qualification period' for a continuous period (not counting the day on which the taxpayer acquired the interest in the shares or, if the taxpayer has disposed of the interest in the shares, the day on which the disposal occurred) of not less than 90 days where the underlying shares are preference shares. However, in the case of beneficiaries of a widely held trust the relevant provision is section 160APHP of the ITAA 1936.

82. Under section 160APHP of the ITAA 1936 a beneficiary of a widely held trust will be a qualified person in relation to a dividend paid on any of the shares to which a distribution from the trust to the beneficiary is attributable if the relevant interest in the shares are held 'at risk' during the relevant 'qualification period' for a continuous period (not counting the day on which the taxpayer acquired the interest in the shares or, if the taxpayer has disposed of the interest in the shares, the day on which the disposal occurred) of not less than 45 days.

83. *Qualification period:* Where neither the taxpayer nor an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the distribution, the relevant qualification period will be the primary qualification period. On the assumption that Investors do not make any related payments, the relevant qualification period in the present case would be the primary qualification period. The primary qualification period commences on the day after the day on which the interests were acquired and in the case of preference shares, ends on the 90th day after the interests became *ex dividend.* During this period the interest in the shares are required to be held at risk for the requisite period of 45 days for ordinary shares and 90 days for preference shares. However in the case of beneficiaries of a widely held trust the requisite period for holding the interest at risk will be 45 days irrespective of whether the share is an ordinary share or a preference share.

84. *At risk*: An interest in shares will be taken to have been held at risk by a taxpayer if the taxpayer is exposed to at least 30% of the risk of loss or opportunities for gain associated with the interest in the shares. Delta is a concept used to measure the relevant risk. If a taxpayer's net position in respect of a given day is less than 0.3, the taxpayer will be taken to have materially diminished their risk of loss or opportunity for gain and those days would be excluded when determining if the shares have been held at risk for the requisite number of days during the primary qualification period.

85. Section 160APHL of the ITAA 1936 sets out how to determine a beneficiary's interest in the trust holding (that is, the shares held by the trustee of the trust) and looks at how to determine the level of risk associated with that interest. A beneficiary's interest in shares held by the trustee is determined in proportion to the beneficiary's share of the dividend income derived by the trust under subsection 160APHL(5) of the ITAA 1936 for non-widely held trusts and subsection 160APHL(6) of the ITAA 1936 for widely held trusts. Under subsection 160APHL(7) of the ITAA 1936, the interest of the beneficiary representing a long position will be accorded a delta of +1 in relation to itself (positions are defined in section 160APHJ of the ITAA 1936).

86. Subsection 160APHL(10) of the ITAA 1936 states that if the trust is not a family trust (within the meaning of Schedule 2F of the ITAA 1936), a deceased estate or part of an employee share scheme, then the taxpayer will have an additional short position equal to the long position that arose under subsection 160APHL(7) of the ITAA 1936 (that is, a position with a delta of -1), and a long position equal to so much of the taxpayer's interest in the trust holding as is a fixed interest. For the purposes of subsection 160APHL(10) of the ITAA 1936, a taxpayer's interest in the trust holding is a fixed interest to the extent that the interest is constituted by a vested and indefeasible interest in so much of the corpus of the trust as is comprised by the trust holding (subsection 160APHL(11) of the ITAA 1936).

87. Therefore in working out whether a beneficiary of a trust is a qualified person it is crucial to determine whether or not the trust is a 'widely held trust'. A widely held trust is defined in section 160APHD of the ITAA 1936 as, relevantly, a trust that is not a 'closely held fixed trust'. A closely held fixed trust is a fixed trust with not more than 20 entities (counting entities who are associates as one entity) with interests in the trust that together entitle them to not less than 75% of the beneficial interests in the income or capital of the trust. The Westpac TPS Trust is a widely held trust for the purposes of section 160APHD.

Westpac TPS Trust is a widely held trust

88. The Westpac TPS Trust is a widely held trust. A beneficiary's interest in shares held by the trustee of a widely held trust will be determined in proportion to the beneficiary's share of the dividend income derived by the trust. That beneficiary's interest is a long position with a delta of +1 in relation to itself. However, in determining a taxpayer's net delta, all other long and short positions in respect of the interest in the shares are also required to be taken into consideration. Westpac TPS Holders will have no other positions in relation to the Westpac TPS on which distributions attributable to the franked distributions in respect of the Notes will be paid.

89. Having considered the relevant positions it can be concluded that the Westpac TPS Holders will have a net delta in excess of 0.3 in relation to their interest in the Notes and will be taken to have held their interest in the Notes at risk.

90. Westpac TPS Holders will not dispose of their Westpac TPS before a period of at least 90 days (excluding the date of acquisition and disposal) beginning the day after allotment of the Westpac TPS.

91. On the basis of the information provided, and having regard to the assumptions and qualifications set out in this Ruling, the Westpac TPS Holders will have held their Westpac TPS at risk for a period of at least 45 days and will be taken to be qualified persons in relation to the franked distributions paid in respect of the Notes.

92. The application of section 204-30 of the ITAA 1997 and section 177EA of the ITAA 1936 is discussed at paragraphs 93 to 101 of this Ruling.

The anti-avoidance provisions

Section 177EA of the ITAA 1936

93. Section 177EA of the ITAA 1936 is primarily directed at schemes involving franking credit trading. Its introduction was designed to secure the integrity of one of the underlying principles of the dividend imputation system. Namely, to ensure that the benefits of imputation are restricted to the true economic owners of the shares and only to the extent that those shareholders are able to use those franking credits themselves. Subsection 177EA(3) provides that section 177EA applies if:

- there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity (paragraph 177EA(3)(a) of the ITAA 1936); and
- either:
  - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests (subparagraph 177EA(3)(b)(i) of the ITAA 1936); or
  - (ii) 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 subparagraph 177EA(3)(b)(ii) of the ITAA 1936); and
- the distribution was, or is expected to be, a franked distribution (paragraph 177EA(3)(c) of the ITAA 1936); and

- except for section 177EA, a person (the 'relevant taxpayer') would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution (paragraph 177EA(3)(d) of the ITAA 1936); and
- 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 (paragraph 177EA(3)(e) of the ITAA 1936).

94. Under subsection 177EA(14) of the ITAA 1936 a scheme for a disposition of membership interests is defined widely and includes the issuing of a membership interest or creating an interest in membership interests.

95. It is noted that paragraph 177EA(3)(a) of the ITAA 1936 refers to a disposition of membership interests in a *corporate* tax entity. Pursuant to section 960-115 of the ITAA 1997, a corporate tax entity is a company, a corporate limited partnership, a corporate unit trust or a public trading trust. Subsection 177EA(12) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies to non-share equity interests, equity holders and non-share dividends in the same way as it applies to membership interests, members and distributions. Therefore, the Notes issued by Westpac, represent non-share equity interests, which for the purposes of section 177EA are to be treated in the same way as membership interests. Consequently, the issue of the Notes by Westpac to the Issuer, as responsible entity of the Westpac TPS Trust, will represent a disposition of a membership interest.

96. Under subsection 177EA(13) of the ITAA 1936, a person has an interest in membership interests if:

- the person has any legal or equitable interest in the membership interests (paragraph 177EA(13)(a) of the ITAA 1936); or
- the person is a beneficiary of a trust (including a potential beneficiary of a discretionary trust) and;
  - (i) the membership interests form, or will form, part of the trust estate (subparagraph 177EA(13)(c)(i) of the ITAA 1936); or
  - (ii) the trust derives, or will derive, income indirectly through interposed companies, trusts or partnerships, from distributions made on the membership interests (subparagraph 177EA(13)(c)(ii) of the ITAA 1936).

97. As the Westpac TPS Trust will hold the Notes issued by Westpac, the issue of the Westpac TPS to beneficiaries means that the Westpac TPS Holders have an interest in membership interests.

98. In the present case the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that there is a purpose, which is more than merely an incidental purpose, of conferring an imputation benefit under the scheme. Under this arrangement the relevant taxpayer is the Westpac TPS Holder and the scheme comprises the circumstances surrounding the issue of the Westpac TPS.

99. In arriving at a conclusion the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there 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 not be present at any one time in any one scheme.

100. On the basis of the information provided, and having regard to the assumptions and qualifications set out in this Ruling and the relevant circumstances of the scheme, it would not currently be reasonable to conclude that in entering into the scheme, Westpac, the Issuer and/or the Westpac TPS Holders demonstrate the objective purpose of securing imputation benefits for the Westpac TPS Holders. To the extent that any imputation benefits are secured, those benefits are considered to be incidental to the more significant objective purposes of reducing the cost of capital employed by Westpac and the raising of Tier 1 capital (subject to APRA limits on innovative Tier 1 capital), and thereby enhancing efficiency and maximising shareholder value.

Section 204-30 of the ITAA 1997

101. Section 204-30 of the ITAA 1997 is a general anti-streaming measure preventing the streaming of imputation benefits between members of a corporate tax entity. The Westpac TPS Trust is not a corporate tax entity and, therefore, the provision does not apply in relation to the imputation benefits obtained by the Westpac TPS Holders.

Appendix 2 – Detailed contents list

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

References

Previous draft:
Not previously issued as a draft

Subject references:
- dividend arrangements

Legislative references:
- ITAA 1936 98
- ITAA 1936 99
- ITAA 1936 99A
- ITAA 1936 160AOA
- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 160APHD
- ITAA 1936 160APHJ
- ITAA 1936 160APHL
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- ITAA 1936 160APHL(6)
- ITAA 1936 160APHL(7)
- ITAA 1936 160APHL(10)
- ITAA 1936 160APHL(11)
- ITAA 1936 160APHN
- ITAA 1936 160APHO
- ITAA 1936 160APHP
- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1936 177EA(3)(a)
- ITAA 1936 177EA(3)(b)
- ITAA 1936 177EA(3)(b)(i)
- ITAA 1936 177EA(3)(b)(ii)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(3)(e)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(12)
- ITAA 1936 177EA(13)
- ITAA 1936 177EA(13)(a)
- ITAA 1936 177EA(13)(c)(i)
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- ITAA 1997 67-25(1A)
- ITAA 1997 67-25(1B)
- ITAA 1997 67-25(1C)
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- ITAA 1997 202-40(2)
- ITAA 1997 202-45
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- ITAA 1997 202-45(f)
- ITAA 1997 202-45(g)
- ITAA 1997 202-45(h)
- ITAA 1997 202-45(i)
- ITAA 1997 202-45(j)
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- ITAA 1997 204-30(8)
- ITAA 1997 Subdiv 207-B
- ITAA 1997 Subdiv 207-F
- ITAA 1997 207-35(1)
- ITAA 1997 207-35(3)
- ITAA 1997 207-45
- ITAA 1997 207-45(c)
- ITAA 1997 207-45(d)
- ITAA 1997 207-50
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- ITAA 1997 207-55
- ITAA 1997 207-57
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- ITAA 1997 207-122
- ITAA 1997 207-124
- ITAA 1997 207-126
- ITAA 1997 207-150
- ITAA 1997 960-115
- ITAA 1997 960-130(1)
- ITAA 1997 Div 974
- ITAA 1997 Subdiv 974-B
- ITAA 1997 974-115
- ITAA 1997 974-120
- ITAA 1997 974-75(1)
- ITAA 1997 974-120
- ITAA 1997 995-1(1)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

ATO references
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