

CR 2012/111 - Income tax: Bank of Queensland - issue of convertible preference shares



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Class Ruling

Income tax: Bank of Queensland – issue of convertible preference shares

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

What this Ruling is about

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

Relevant provision(s)

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

- section 6BA of the *Income Tax Assessment Act 1936* (ITAA 1936);
- subsection 44(1) of the ITAA 1936;
- section 45 of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- former Division 1A of Part IIIA of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 67 of the ITAA 1997;

- Division 104 of the ITAA 1997;
- subsection 110-25(2) of the ITAA 1997;
- subsection 110-55(2) of the ITAA 1997;
- Subdivision 130-A of the ITAA 1997;
- subsection 130-60(3) of the ITAA 1997;
- subsection 204-30(3) of the ITAA 1997; and
- Division 207 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise stated.

Class of entities

3. In this Ruling, unless otherwise defined, capitalised terms take on the same meaning as in the Terms of Issue of the BOQ CPS (Terms of Issue).

4. The class of entities to which this Ruling applies are subscribers for convertible preference shares (CPS) in the Bank of Queensland (BOQ) who:

- hold BOQ CPS on capital account;
- are 'Australian residents' within the meaning of subsection 6(1) of the ITAA 1936 during the period in which they hold BOQ CPS; and
- are not subject to the Taxation of Financial Arrangements (TOFA) rules in Division 230 in relation to financial arrangements under the scheme.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

5. The class of entities to which this Ruling applies does not extend to Holders who do not acquire their interest by initial application under the *Prospectus and PEPS Reinvestment Offer Information* dated 19 November 2012 (Prospectus) that replaced the Prospects dated and lodged with ASIC on 7 November 2012 but includes holders of BOQ's Perpetual Equity Preference Shares (PEPS) who acquire their BOQ CPS as part of the Reinvestment Offer referred to in the Prospectus.

6. This Ruling does not deal with how the taxation law applies to Holders who hold their BOQ CPS as trading stock or revenue assets.

7. This Ruling does not consider the tax implications of the Redemption of BOQ CPS under Clause 14 of the Terms of Issue.

8. This Ruling does not consider the tax implications of the Write-Off of BOQ CPS.

9. This Ruling does not consider how the taxation law applies to a Nominated Transferee who acquires the BOQ CPS in accordance with Clause 16 of the Terms of Issue.

10. This Ruling does not consider how the gross-up and tax offset rules in Division 207 apply to partnership or trustee holders, or to indirect distributions to partners in a partnership, or beneficiaries or trustees of a trust.

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

Qualifications

12. 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 62 of this Ruling.

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

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

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Date of effect

15. This Ruling applies from 1 July 2012 to 30 June 2021. The Ruling continues to apply after 30 June 2021 to all entities within the specified class who entered into the specified scheme at the time of the initial subscription for BOQ CPS. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

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

- Application for Class Ruling dated 31 October 2012.
- Prospectus.
- The Terms of Issue.

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

17. BOQ is a financial institution whose operations cover retail banking, business banking, various forms of financing and insurance.

18. BOQ is an Australian resident company with its ordinary shares listed on the Australian Securities Exchange (ASX).

19. BOQ is the parent company in the group. BOQ operates predominantly in Australia although it has a branch and a subsidiary in New Zealand. The BOQ CPS will be issued by the parent company.

20. In the Prospectus, BOQ intends to raise \$200 million through the offer of CPS (each with a face value of \$100) with the ability to raise more or less.

21. BOQ is intending to apply for the BOQ CPS to be quoted on the ASX.

22. The funds raised from the issue of BOQ CPS will be used for the general business purposes of BOQ in Australia including replacing BOQ's PEPS.

23. The offer is part of BOQ's capital management strategy to further strengthen its Tier 1 capital position.

24. The Australian Prudential Regulation Authority (APRA) has confirmed that BOQ CPS will be treated as Additional Tier 1 Capital from 1 January 2013, which is the date APRA's Basel III Prudential Standards are expected to become effective.

25. The PEPS which BOQ currently has on issue constitute \$200 million of Tier 1 Capital.

26. It is expected that the PEPS will not fully count as Tier 1 Capital from 1 January 2013. APRA has granted transitional relief so PEPS can be included in Additional Tier 1 Capital on a reducing basis over time so that they will gradually no longer be included in BOQ's Tier 1 capital position. As such, BOQ is seeking to replace the PEPS with the CPS. This will occur by BOQ offering a selective buy back to existing PEPS holders under the Reinvestment Offer.

27. Under the Reinvestment Offer, Eligible PEPS holder will be able to elect for some or all of their PEPS to be bought back by BOQ for \$100 each on 24 December 2012. The \$100 buy-back proceeds on each PEPS will be directly applied to subscribe for one CPS, with a Face Value of \$100.

28. BOQ CPS will also be offered to other investors.

Main features of the BOQ CPS

29. The CPS are fully paid, unsecured, preference shares, paying discretionary, floating rate non-cumulative dividends.

30. The issue price of each CPS (face value) is \$100. CPS are fully paid up to \$100 face value on issue.

31. A Holder generally does not have voting rights, except in the limited circumstances described in Clause 12.1 of the Terms of Issue.

Dividend calculation

32. Subject to the conditions outlined under the heading, 'Dividend payment conditions' below, BOQ CPS will pay a dividend (Dividend) on each relevant Dividend Payment Date.

33. The Dividend is calculated as:

$$\text{Dividend} = \frac{(\text{Dividend Rate} \times \text{Face Value} \times D)}{365}$$

Where:

D is the number of days in the period from (and including):

- for the first Dividend Payment Date, the Issue Date until (but not including) the first Dividend Payment Date
- for any subsequent Dividend Payment Date, the preceding Dividend Payment Date until (but not including) the relevant Dividend Payment Date.

Face Value is \$100.

Dividend Rate (expressed as a percentage rate per annum) is:

$$(\text{BBR} + \text{Margin}) \times (1 - t)$$

Where:

BBR means the Bank Bill Swap Rate on the first Business Day of the Dividend Period, expressed as a percentage per annum.

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

t is the Australian corporate tax rate applicable to the franking account of the Bank at the relevant Dividend Payment Date, expressed as a decimal.

Franking and gross-up

34. The Dividend payments are expected to be fully franked. However, if any Dividend is not franked or only partially franked, the Dividend will be grossed-up to the extent that the franking percentage of the Dividend is less than 100%.

Dividend payment dates

35. Dividend payments are to be paid in arrears on each Dividend Payment Date, the first Dividend Payment Date being 15 April 2013 and thereafter semi-annually on each 15 April and 15 October until the CPS are Converted or Redeemed (in which case the Conversion Date or Redemption Date will be the final Dividend Payment Date). If any of these dates is not a business day, then the Dividend Payment Date will be the next business day.

Dividend payment conditions

36. The payment of a Dividend (including on Redemption and on Conversion) is subject to:

- the Directors, in their absolute discretion, determining that the Dividend is payable;
- the Bank being lawfully able to pay the Dividend under the *Corporations Act 2001*;
- payment of the Dividend not resulting in any breach of APRA's then prevailing capital adequacy standards and guidelines as they are applied to the Group at the time, unless otherwise approved by APRA; and
- APRA not otherwise objecting to the payment on the relevant Dividend Payment Date.

37. The Directors will not determine a Dividend to be payable if, in their opinion, making the payment would result in BOQ becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*.

Dividends are non-cumulative

38. If all or any part of a Dividend is not paid because of the provisions of the Terms of Issue or because of any applicable law, BOQ will have no liability to pay, and the Holders will have no right to be paid, any amount in respect of that Dividend.

39. The Holders will have no claim or entitlement (including without limitation on winding up of BOQ) in respect of such non-payment, and such non-payment will not constitute an event of default or give Holders any right to apply for the winding-up or administration of BOQ, or cause a receiver, or receiver and manager, to be appointed in respect of BOQ.

40. No interest accrues on any unpaid Dividend and the Holder has no claim or entitlement in respect of interest on any unpaid Dividend.

Restrictions in the case of non-payment of Dividends

41. If a Dividend has not been paid in full on a Dividend Payment Date, BOQ must not until and including the next Dividend Payment Date:

- declare, determine or pay any dividends or distributions on any Ordinary Shares; or
- buy back or reduce capital on any Ordinary Shares,

unless:

- the Dividend is paid in full within 3 Business Days of the Relevant Dividend Payment Date;
- all BOQ CPS have been Converted or Redeemed; or
- a Special Resolution of the Holders has been passed approving such action.

42. The restrictions above do not apply in the limited circumstances stipulated in Clause 6.11 of the Terms of Issue.

Conversion, Redemption or Transfer of BOQ CPS

43. The CPS will mandatorily convert into Ordinary Shares in the circumstances referred to below. BOQ may also Redeem, Convert or Transfer the CPS in certain circumstances. The Holders have no right to seek or initiate Conversion or Redemption.

Mandatory Conversion

44. Subject to early Conversion or Redemption (described below), the CPS will mandatorily Convert to Ordinary Shares:

- on a Mandatory Conversion Date;
- following a Capital Trigger Event or Non-Viability Trigger Event; or
- following an Acquisition Event.

45. The Mandatory Conversion Date will be the first of the following dates:

- 15 April 2020 (if the Conversion Conditions are satisfied); or
- A Dividend Payment Date after that date on which date the Conversion Conditions are satisfied.

46. A Capital Trigger Event will broadly occur if BOQ's ratio of Common Equity Tier 1 Capital falls to or below 5.125%.

47. A Non-Viability Trigger Event arises where APRA has provided a written determination to BOQ that all (or some) of the CPS (or other relevant instruments) must be converted or written off as without the conversion or write-off BOQ would become non-viable or without a public sector injection of capital, BOQ would become, in APRA's opinion, non-viable.

48. An Acquisition Event will broadly occur where:

- there is a takeover bid to acquire all or some of the Ordinary Shares of BOQ and the bidder has a relevant interest greater than 50% of the Ordinary Shares on issue; or
- a court approves a scheme of arrangement which would result in a person having a relevant interest greater than 50% of the Ordinary Shares on issue after the scheme is implemented.

Early Redemption or Conversion

49. Subject to the Terms of Issue, BOQ may Redeem the CPS or Convert them to ordinary shares or Transfer the CPS:

- following the occurrence of a Tax Event or Regulatory Event; or
- on an Optional Conversion/Redemption Date.

50. BOQ may Convert the BOQ CPS to ordinary shares following a Potential Acquisition Event.

51. Early Redemption, Conversion or Transfer requires written approval from APRA.

52. BOQ may not Redeem the CPS following a Capital Trigger Event or Non-Viability Trigger Event.

Conversion mechanics

53. On any Conversion, the CPS will convert into Ordinary Shares by the variation of the rights and restrictions attaching to the CPS, such that each of the CPS will have all the rights attaching to one fully paid Ordinary Share and will rank equally with all other Ordinary Shares on issue (refer to Clause 15 of the Terms of Issue). In addition, all other rights and restrictions conferred on the CPS under the Terms of Issue will generally no longer have any effect.

54. Each Holder may also be allotted an additional number of fully paid Ordinary Shares for each BOQ CPS converted, in accordance with the relevant formula set out in the Terms of Issue.

55. If, following a Capital Trigger Event or a Non-Viability Trigger Event, the number of Ordinary Shares that a Holder would be entitled to receive for each of the CPS they hold would exceed the Maximum Conversion Number, the Holder will instead receive a number of Ordinary Shares equal to the Maximum Conversion Number for each CPS.

56. Conversion does not constitute redemption, buy-back or cancellation of a CPS or an issue, allotment or creation of a new share (other than any additional Ordinary Shares allotted).

Conversion conditions

57. Mandatory Conversion (excluding upon a Capital Trigger Event or Non-Viability Trigger Event), Early Conversion and Conversion upon an Acquisition Event are subject to the satisfaction of three conversion conditions, broadly being:

- The first conversion condition is tested on the 25th Business Day before the relevant date, and requires that the conversion number is no greater than 90% of the Maximum Conversion Number.
- The second conversion condition requires that the conversion number on the relevant date is no greater than the Maximum Conversion Number.
- The third conversion condition requires that no Delisting Event applies in respect of the relevant date.

58. A Delisting Event broadly occurs where the Ordinary Shares cease to be listed on the ASX on or before a relevant date, trading in the Ordinary Shares has been suspended on the relevant date and at least five consecutive days before that date, or BOQ is prevented from converting the CPS by reasons of a law or court order.

Maximum Conversion Number

59. The Maximum Conversion Number is calculated as the Face Value divided by a Relevant Fraction of the Pre-Issue VWAP. The Relevant Fraction is 50% if Conversion is occurring on a Mandatory Conversion Date or before 1 January 2013, and 20% if Conversion is occurring at any other time.

Meaning of Redemption

60. Redemption, in respect of a CPS, means the CPS is redeemed, bought back (other than by an on-market buy-back) or cancelled pursuant to a reduction of capital (or any combination of these) for an amount of cash equal to the Face Value and any due but unpaid dividends.

Transfer

61. In accordance with Clause 13.1(d), Clause 13.6(c)(iii) and Clause 16 of the Terms of Issue, in certain limited circumstances, the CPS would be transferred to a Nominated Transferee for Face Value.

Non-Operating Holding Company (NOHC)

62. Clause 18.4 of the Terms of Issue covers a scenario in the event there is a replacement of BOQ as the ultimate holding company of the BOQ Group by an Approved NOHC.

63. If the replacement of BOQ by an Approved NOHC occurs, the Terms of Issue will be amended such that the Approved NOHC will be the issuer of ordinary shares on conversion.

Other matters

64. This Ruling is made on the basis that:

- (a) The documents listed in paragraph 14 of this Ruling provide a complete and accurate description of the scheme and the scheme was implemented according to the terms of these documents.
- (b) During the term of the scheme, BOQ will be a resident of Australia under the income tax laws of Australia.
- (c) The majority of the Holders are expected to be residents of Australia for tax purposes, although some may be non-residents.
- (d) The BOQ CPS are an equity interest in BOQ pursuant to Division 974.
- (e) Dividends paid in respect of the BOQ CPS are frankable distributions under section 202-40 and are not unfrankable distributions under section 202-45.
- (f) Dividends paid in respect of the BOQ CPS will be dividends under subsection 6(1) of the ITAA 1936.
- (g) BOQ will frank the Dividends on BOQ CPS at the same franking percentage as the benchmark for the franking period in which the payments are made.
- (h) Ordinary Shares issued on Conversion of the BOQ CPS will be equity interests in BOQ pursuant to Division 974.
- (i) A Holder, and their associates, do not have any 'positions' (within the meaning of former section 160APHJ of the ITAA 1936) in relation to the BOQ CPS apart from the holding of the BOQ CPS themselves that would cause a Holder not to be a 'qualified person' for the purposes of Division 1A of former Part IIIA of the ITAA 1936.

- (j) A Holder and their associates will not make any 'related payments' (within the meaning of former section 160APHN of the ITAA 1936) in relation to Distributions payable in respect of the BOQ CPS.
- (k) Holders will not dispose of BOQ CPS before a period of at least 90 days (including the day of acquisition and the day of disposal) beginning the day after the acquisition of the CPS.
- (l) BOQ will not differentially frank distributions to different Holders in respect of the BOQ CPS according to the tax status of Holders or on any other basis.
- (m) The dividend payout ratios and BOQ's policies in relation to the franking of its distributions on ordinary share capital, other preference share capital and non-share equity interests of BOQ (to the extent such dividends/distributions are frankable) are not expected to change as a result of the issue of the CPS.
- (n) The allotment of Ordinary Shares will not affect BOQ's dividend franking policy (which applies to its Ordinary Shares, preference shares and non-share equity interests).
- (o) Dividends payable in respect of the BOQ CPS will not be debited to BOQ's share capital account or non-share capital account.
- (p) The share capital of BOQ will not become tainted (within the meaning of Division 197), by the issue of the BOQ CPS or Ordinary Shares on Conversion.
- (q) Dividends on BOQ CPS will not be sourced, directly or indirectly, from BOQ's share capital account.
- (r) BOQ expects to have sufficient available profits from which to pay Dividends and have net assets in excess of ordinary share capital, immediately before the payment of any Dividends payable in respect of the BOQ CPS.
- (s) No part of the Dividends will be sourced, directly or indirectly, from unrealised or untaxed profits.
- (t) BOQ expects to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account).

Ruling

Acquisition time of BOQ CPS

65. Under item 2 in the table in section 109-10, Holders will acquire the BOQ CPS on 24 December 2012, being the date the CPS will be issued to Holders.

BOQ CPS cost base and reduced cost base

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

Inclusion of Dividends in assessable income

67. Dividends paid in respect of BOQ CPS will be included in the assessable income of Holders under subparagraph 44(1)(a)(i) of the ITAA 1936.

Franking credit and entitlement to a tax offset

68. Holders will include the amount of the franking credit attached to the Dividend in their assessable income pursuant to subsection 207-20(1).

69. Holders will be entitled to a tax offset equal to the franking credit received on the Dividends under subsection 207-20(2), unless Subdivision 207-D applies.

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

Imputation benefits

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

Section 177EA

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

Gross-up and tax offset rules

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

74. Holders will be 'qualified persons' for the purposes of Division 1A of former Part IIIA of the ITAA 1936 provided they held their shares 'at risk' for the primary qualifying period pursuant to section 160APHO of the ITAA 1936, and have not made a 'related payment' within the meaning affected by former sections 160APHN and 160APHNA of the ITAA 1936.

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

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

76. CGT event H2 in section 104-155 will not happen on the Conversion of each CPS involving the allotment of additional Ordinary Shares as a cost base adjustment will be made to CPS because of the allotment of the additional Ordinary Shares. No other CGT event in Division 104 will happen on the Conversion of CPS involving the allotment of additional Ordinary Shares.

Cost base of the additional Ordinary Shares

77. Section 6BA of the ITAA 1936 and Subdivision 130-A will apply to apportion the first element of the cost base and reduced cost base of each BOQ CPS over the Ordinary Shares and any additional Ordinary Shares allotted by BOQ pursuant to a Conversion.

Acquisition time of the additional Ordinary Shares

78. Under subsection 130-20(3), the additional Ordinary Shares received by a Holder as part of a Conversion are taken to be acquired at the time CPS were originally acquired by the Holder, being 24 December 2012.

Allotment of additional Ordinary Shares – Dividend

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

The value of additional Ordinary Shares – ordinary income

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

Section 45

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

Section 45A

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

Section 45B

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

Amendment of Terms of Issue in respect of an Approved NOHC

84. The amendment to the Terms of Issue to effect the substitution of an Approved NOHC as the issuer of ordinary shares to Holders on Conversion of the BOQ CPS will result in CGT event H2 happening.

85. However, no Holder will make a capital gain or capital loss as a result of CGT event H2 happening as there are no capital proceeds arising from the amendment to the Terms of Issue and no incidental costs incurred by the Holders that relate to the amendments.

Conversion of each CPS and allotment of ordinary shares in an Approved NOHC – CGT implications

86. Where a NOHC is interposed as the ultimate holding company of BOQ, the Conversion of each CPS and the allotment of NOHC ordinary shares to Holders will result in CGT event C2 happening.

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

Acquisition time of Approved NOHC Shares

88. The Approved NOHC Shares are taken to be acquired by Holders at the time of the Conversion of the CPS into Approved NOHC ordinary shares.

Cost base of Approved NOHC Shares

89. The first element of the cost base and the reduced cost base of each Approved NOHC Share allocated to a Holder will be their cost base in the CPS at the time of Conversion divided by the number of Approved NOHC Shares they receive for each CPS.

Commissioner of Taxation5 December 2012

Appendix 1 – Explanation

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

Acquisition time of BOQ CPS

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

91. The CPS will be issued on 24 December 2012. Therefore, under item 2 in the table in section 109-10, the CPS are acquired on 24 December 2012.

BOQ CPS cost base and reduced cost base

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

93. The Face Value of each BOQ CPS is \$100. Accordingly, when the CPS are issued, the first element of the cost base and reduced cost base of each BOQ CPS is \$100.

Inclusion of dividends in assessable income

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

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

Franking credit and entitlement to a tax offset

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

97. Where a franked distribution is paid by an Australian resident company to a shareholder, the assessable income of the shareholder must also include the franking credit attached to the dividend under Division 207.

98. Accordingly, the franking credit attached to the Dividends paid by BOQ to Holders must be included in their assessable income pursuant to subsection 207-20(1).

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

100. The Holders who are entitled to a tax offset under subsection 207-20(2) in respect of the franking credit received, will also be subject to the refundable offset rules contained in Division 67, unless specifically excluded under section 67-25.

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

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

Imputation benefits

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

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

- an 'imputation benefit' is, or apart from section 204-30 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a));
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)); and
- the other member (disadvantaged member) of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c)).

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

106. The BOQ CPS will be listed on the ASX and hence will be available for investment by different types of investors.

107. All Holders will receive Dividends franked to the same extent regardless of their tax attributes or their individual tax position.

108. BOQ intends to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account). This includes Dividends payable in respect of the CPS.

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

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

Section 177EA

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

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

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

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; 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; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and

- (d) except for this section, the person (the relevant taxpayer) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

113. The conditions in subparagraphs 112(a) to (d) of this Ruling are satisfied.

114. Accordingly, the issue is whether having regard to the relevant circumstances of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme, did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit (paragraph 177EA(3)(e) of the ITAA 1936).

115. Circumstances which are relevant in determining whether any person has the requisite purpose include, but are not limited to, the factors listed in subsection 177EA(17) of the ITAA 1936.

116. The relevant circumstances listed encompass a range of circumstances which taken individually or collectively could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may or may not be present at any one time in relation to a particular scheme.

117. Based on the information provided and the qualifications set out in this Ruling, the Commissioner's consideration of all of the relevant circumstances of the scheme would not, on balance, lead to a conclusion that the purpose of enabling Holders to obtain imputation benefits is more than incidental to BOQ's purpose of raising Tier 1 Capital to meet its capital adequacy requirements.

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

Gross-up and tax offset rules

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

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

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

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

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

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

124. Holders will be qualified persons, provided that:

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

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

126. The Commissioner has confirmed that he will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Dividends paid by BOQ to Holders (see paragraphs 101 to 116 of this Ruling).

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

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

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

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

130. Subject to the satisfaction of the Conversion Conditions, the CPS will Convert into Ordinary Shares on 15 April 2020. If the Conversion Conditions are not satisfied on that date, the Mandatory Conversion Date moves to the next Dividend Payment Date on which the Conversion Conditions are satisfied. The CPS may Convert earlier if BOQ elects to Convert the CPS into Ordinary Shares following the occurrence of certain events defined in the Terms of Issue.

131. Each BOQ CPS is comprised of a bundle of rights; however, those rights are not separate pieces of property capable of being divided out and held separately. Accordingly, the rights attaching to each CPS do not constitute individual assets as defined by section 108-5, but rather combine to make up the relevant CGT asset, being the share (Taxation Ruling TR 94/30 *Income tax: capital gains tax implications of varying rights attaching to shares*).

CGT event C2

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

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

133. The mere variation of rights attaching to CPS and allotment of an additional number of Ordinary Shares for no consideration is not a 'redemption' or 'cancellation' of the share under paragraph 104-25(1)(a).

134. Further, the Conversion of CPS to Ordinary Shares by the variation of the rights attaching to CPS does not result in the ownership of an intangible asset coming to an end and therefore paragraph 104-25(1)(f) will not apply.

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

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

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

CGT event H2

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

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

139. The Conversion of CPS involving the allotment of additional Ordinary Shares will result in an adjustment to the cost base and reduced cost base of the Converted CPS and any additional Ordinary Shares allotted by BOQ under Subdivision 130-A of the ITAA 1997 or section 6BA of the ITAA 1936 (see paragraphs 144 to 148 of this Ruling).

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

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

Cost base of the additional Ordinary Shares

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

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

144. Further, Subdivision 130-A of the ITAA 1997 applies in a similar manner. It provides special rules relating to the time of acquisition and the cost base of bonus equities for CGT purposes.

145. Section 130-20 of the ITAA 1997 sets out what happens if an entity owns shares in a company (original equities) and the company issues other shares (bonus equities) in relation to the original equities.

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

Acquisition time of the additional Ordinary Shares

147. Item 1 in the table in subsection 130-20(3) of the ITAA 1997 provides that if you acquire the original equities on or after 20 September 1985, you are taken to have acquired the bonus equities when you acquired the original equities.

148. Accordingly, the Holders are taken to have acquired the additional Ordinary Shares at the time when the CPS were originally acquired by the Holders, being 24 December 2012.

Allotment of additional Ordinary Shares – Dividend

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

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

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

152. Furthermore, no amount is credited to the Holders, nor is an amount paid out of profits.

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

The value of additional Ordinary Shares – ordinary income

154. The allotment of additional Ordinary Shares will be a bonus issue within the meaning of paragraph 254A(1)(a) of the *Corporations Act 2001*, that is, an issue of shares for which consideration is not payable to BOQ. The issue of additional Ordinary Shares will be a re-expression of the Holder's interest in the share capital of BOQ.

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

Section 45

156. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10% (subsection 45(3) of ITAA 1936).

157. BOQ's historical franking policy is to fully frank the dividends it pays. BOQ expects to continue its franking policy and fully frank its dividends for all of its shareholders, including the Holders, in the foreseeable future.

158. Upon Conversion of the BOQ CPS, the Holders may receive additional Ordinary Shares in BOQ. The issue of additional Ordinary Shares in these circumstances will not be an alternative to the receipt of any dividends payable by BOQ, nor will there be any link between the issue of the additional Ordinary Shares and the timing of the declaration or payment of any dividends by BOQ.

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

Section 45A

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

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

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

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

Section 45B

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

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

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

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

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

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

Amendment of Terms of Issue in respect of an Approved NOHC

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

171. The Terms of Issue provide that BOQ may amend the Terms of Issue where necessary and appropriate to effect the substitution of an Approved NOHC as the issuer of ordinary shares on Conversion.

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

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

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

175. Holders make no capital gain or capital loss from the happening of CGT event H2 as there are no capital proceeds because of the amendments to the Terms of Issue and no incidental costs are incurred by the Holders that relate to these amendments. No other CGT event will happen because of the amendments to the Terms of Issue.

Conversion of each CPS and allotment of ordinary shares in an Approved NOHC – CGT implications

176. Under section 104-25, CGT event C2 happens if, among other things, the ownership of an intangible asset that is a convertible interest ends by the conversion of the asset into another asset (paragraph 104-25(1)(f)).

177. However, Subdivision 130-C modifies how the general CGT rules apply where there is an acquisition of shares by the conversion of a convertible interest. If the BOQ CPS are convertible interests, any capital gain or capital loss made under CGT event C2 happening in respect to the Conversion of the CPS is disregarded (subsection 130-60(3)).

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

179. An interest (the first interest) is an 'interest that will or may convert into another interest' (the second interest) if the first interest must be, or may be, satisfied by the issue of the second interest (subparagraph 974-165(b)(i)).

180. The Terms of Issue provide for the possibility of an Approved NOHC to be interposed as the ultimate owner of BOQ. If this occurs, BOQ can amend the Terms of Issue and provide notice to Holders that upon Conversion, shares in the Approved NOHC may be allotted to the Holders instead of BOQ Ordinary Shares.

181. The term 'connected entity' is defined in section 995-1 and includes an 'associate' of the entity being tested. 'Associate' is widely defined in section 995-1 and section 318 of the ITAA 1936. As the Approved NOHC will be the parent company of BOQ at the time of the Conversion the Approved NOHC will be an associate, and thus a connected entity of BOQ.

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

Acquisition time of the Approved NOHC Ordinary Shares

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

Cost base of the Approved NOHC Ordinary Shares

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

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Previous draft:

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Related Rulings/Determinations:

TR 94/30; TR 2006/10

Subject references:

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

Legislative references:

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