# *TR 2001/D2 - Income tax: the taxation consequences for taxpayers issuing certain stapled securities*



This document has been finalised by TR 2002/16.

# Draft Taxation Ruling
## Income tax: the taxation consequences for taxpayers issuing certain stapled securities

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***Preamble***

*Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.*

## What this Ruling is about

1. This Ruling considers whether the payments incurred on monies raised through the issue of certain stapled securities are deductible under section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

2. In answering that question the Ruling considers whether:

(a) the payments are deductible under the positive limbs of section 8-1 ITAA 1997 as an expense of deriving income as opposed to the application of income derived;

(b) the payments are interest on a loan;

(c) the payments are of a capital nature within the negative limb of section 8-1 ITAA 1997.

3. The Ruling also considers whether:

(a) the convertible note provisions of Division 3A of the *Income Tax Assessment Act 1936* ('ITAA 1936') apply to deny a deduction for the payments, or Part IVA ITAA 1936 would otherwise apply;

(b) the payment made under the 'Procurement Agreement' to the Underwriters pursuant to the issue of the securities is deductible under section 8-1 ITAA 1997 and in the alternative whether Part IVA ITAA 1936 would apply;

(c) an issuer of stapled securities is obliged to pay or withhold tax on behalf of non-resident investors.

4. This Ruling does not consider the income tax consequences for the investors who acquire the stapled securities.

5. The cases cited in this Ruling that consider deductibility under subsection 51(1) ITAA 1936 have equal application to section 8-1 ITAA 1997. All references to subsection 51(1) ITAA 1936 should be taken as including a reference to section 8-1 ITAA 1997, and vice versa.

## Class of person/arrangement

6. The class of persons to which this Ruling applies are taxpayers who incur expenditure on payments made under stapled security arrangements to investors. The taxpayers may include banks or financial institutions and other corporates, and the holding companies of such entities, which raise capital under the issue of stapled securities otherwise known in the financial markets as 'Income Securities'. These securities as issued by banks may qualify as 'Tier 1 capital' for the regulatory guidelines on capital adequacy of banks issued by the Australian Prudential Regulatory Authority ('APRA').

7. This Ruling applies to stapled security arrangements which comprise a preference share and a Note, or a preference share and the beneficial interest in a Note. The Holder's Interest is the beneficial interest in the Note issued to a Trustee by a wholly-owned subsidiary of the parent company. The subsidiary is a finance company which may have been established for the specific purpose of issuing the Notes. The preference share is issued by the parent company. Only the Trustee may enforce the conditions of the Note on behalf of the investors.

8. The Notes are issued to the Trustee and are held on behalf of the Holders, who upon registration, hold the absolute beneficial interest in the Notes. The 'Initial Holders' are the Underwriters to the public issue of the Income Securities under the Prospectus. The preference shares in the parent company, which may or may not carry on the business of banking in the corporate group, are issued fully paid. The Holder's Interest and the preference shares are acquired at first instance by the Underwriters. Under the Subscription Agreement, the Underwriters subscribe for the fully paid preference share, typically $100, and $100 for the beneficial interest in the Note, a total consideration of $200.

9. The preference share and the Holder's Interest are 'stapled' together upon the issue of the Note to form an Income Security pursuant to the terms of the Trust Deed governing the issue of the Notes and the terms of issue of the preference shares. The Underwriters transfer the stapled security for the face value of the security of $100 to an investor who has subscribed under the Offer

contained in the Prospectus. The Income Securities are also listed on the ASX and may be bought and sold on the secondary market. The investor is then registered as the Holder of the Income Security and is eligible to receive payments under the security. It is a term of issue of the shares and a condition of the Notes that the beneficial interest in the Notes and the shares are only capable of transfer together.

10. Further key features of stapled security arrangements are described in paragraphs 36 to 69 of the Explanation under the heading 'Description of the arrangements'.

## Ruling

**Are the periodic payments deductible under the positive limbs of section 8-1 ITAA 1997 as a loss or outgoing incurred in gaining or producing assessable income, or necessarily incurred in carrying on a business for that purpose?**

11. A distinction should be made between the expenses of deriving income and the application of income derived. A payment to discharge an obligation which arises because of acts done or omitted in the process of deriving income may be sufficiently connected (to earning assessable income). However a payment to discharge an obligation which arises because a derivation of income has occurred is not sufficiently connected.

12. Whether the periodic payments on the Notes are sufficiently connected to the process of deriving income, given that they are variously expressed to be contingent on the existence and extent of a fund of net profits of the Issuer (or an associate) of a current or prior year of income, or payable out of such a fund directly or indirectly, is to be determined on a case by case basis.

**If the periodic payments satisfy the positive limbs of section 8-1 ITAA 1997 is a deduction for the payments denied under the negative limb paragraph 8-1(2)(a) ITAA 1997 being a loss or outgoing of a capital nature?**

13. Given that the character of the capital raised is non-refundable it has a permanent, rather than an ephemeral nature. It creates an enduring advantage. It is a contribution to the capital funding of the business or undertaking. It represents a permanent and unrestricted commitment of funds. The funds are treated as equity in the balance sheet of the company, on a consolidated basis. When banks raise capital by the issue of instruments which qualify as Tier 1 capital, it has the effect of strengthening the balance sheet of the company. Such capital may allow the issuer to raise less expensive capital,

because of the more favourable view taken by credit agencies of these instruments.

14. The facts of the arrangement indicate that the main purpose of the 'borrowings' is to strengthen the company's business entity, structure or organisation set up for the earning of profit, and the obtaining of the 'loan' is not part of the process by which the company operates to obtain regular returns. The distinction which is drawn is that between a more or less recurrent expense involved in running a business and an expenditure for the benefit of the business as a whole. Recurrence is merely one matter to consider.

15. By investing in the income securities, the investor contributes to the capital structure of the 'profit-yielding subject' and that is the character of the advantage sought. The cost of securing and retaining the use of the capital sum for the business is an outgoing which, although periodic, based upon a weighing of all the relevant factors, is of a capital nature for the purposes of the negative limb in subsection 8-1(2) ITAA 1997.

**In the alternative, do the convertible note provisions of Division 3A of Part III of the ITAA 1936 Act apply to deny the interest deduction?**

16. Alternatively, if the periodic payments on the Notes are payments of interest on a loan to the Issuer, the provisions of Division 3A of Part III of the ITAA 1936 arise for consideration.

17. The operative provision of Division 3A - subsection 82R(3) - provides:

> 'An outgoing consisting of interest, or a payment in the nature of interest, under a convertible note to which this section applies shall be deemed not to be an allowable deduction from the assessable income of the company.'

18. The stapled securities fall within the definition of 'convertible note' in paragraph (b) of subsection 82L(1). A 'convertible note' includes a 'note issued by a company that provides, whether in pursuance of or by virtue of a trust deed or otherwise…that the Holder or owner of the note is to have, or may have, any right or option to have allotted or transferred to him or to some other person, or for him or some other person otherwise to acquire, shares in the capital of the company or of some other company'.

19. It is a feature of the stapled security that the interests cannot be dealt with separately, and it is a requirement in the governing documents that a subscriber for the stapled securities receives a share upon subscription, in addition to the interest in the Note. The Holder of the Note interest thus has a right to acquire the share and the

instrument is a 'convertible note' for the purposes of paragraph 82L(1)(b).

20. Section 82R is to be read subject to section 82SA, which provides that section 82R does not apply in relation to a convertible note issued by a company where various requirements are satisfied.

21. Subparagraph 82SA(1)(d)(i) requires that an **option** (called in the section an 'option to convert') is given to the holder or owner of the convertible note to have allotted or transferred to him shares in the capital of the company or of another company.

22. The 'Initial Holder' under the Subscription Agreement, or the subscriber for an Income Security under the Offer held out in the Prospectus, has an enforceable right to the shares, but the investor **must** take them; the investor cannot have the Note consideration in lieu of the shares or vice versa. Subparagraph (1)(d)(ii) of the tests in section 82SA is also subsequently failed on that basis, as are subparagraphs (ii), (iv), (v) (vii), (viii), (ix), (x) (xi).

23. Thus since the holder of a stapled security does not have an option to convert the Note to shares, section 82SA does not prevent subsection 82R(3) from operating to deny a deduction for the payments under the security.

### Application of Part IVA

#### *The payment under the Notes*

24. If the periodic payments made on the stapled securities are deductible under section 8-1 because subsection 82R(3) does not operate, we consider the general anti-avoidance provisions of Part IVA are applicable. As the application of Part IVA depends on the facts, the observations below are necessarily subject to the facts of any particular case.

#### *Identification of the scheme*

25. Where a taxpayer issues a stapled security as described in this Ruling, the scheme may vary from case to case, but the scheme would **always include:**

- the stapling of a Note interest to a preference share;
- the Notes being perpetual;
- the distributions on the Notes being referable to an interest rate but having equity characteristics;

- the distributions on the Notes being contingent upon profits which may represent an application of income derived.

26. The scheme may also include the following features:

- the capital raised representing Tier 1 capital as provided for in the current APRA guidelines on capital adequacy;
- the preference shares issued stapled to the Notes being convertible to ordinary shares.

***The tax benefit test***

27. A tax benefit arises because a deduction would be allowable to the taxpayer in respect of periodic payments made on the Notes, which would not have been, or might reasonably be expected not to have been, allowed in the relevant year of income if the scheme had not been entered into or carried out. If the stapling device was considered to be effective in the circumstances to avoid the operation of the convertible note provisions, a deduction would be allowable under section 8-1 which would otherwise not have been allowable, or might reasonably be expected not to have been allowable pursuant to section 82R.

***Dominant purpose***

28. Some or all of the following factors will be found to be present in an issue of securities to which Part IVA might apply:

- the structure of the securities substitutes deductible interest payments for what would otherwise be non-deductible dividends on preference shares (or ordinary shares upon conversion of the preference shares);
- the stapled securities are marketed to issuers in a manner that emphasises the associated tax benefits of 'cost effective capital';
- if the tax benefit would not be available, the instrument provides for redemption or otherwise ensures that the investor has only an equity interest in the taxpayer for the purpose of recovering their capital; and
- an absence of commercial reasons for stapling the Note to the preference share.

29. Having regard to the eight factors listed in paragraph 177D(b), it is open to conclude objectively that a taxpayer, who has entered into a scheme with some or all of the characteristics outlined in paragraph

183, did so for the dominant purpose of enabling that taxpayer to obtain a tax benefit. In such a case, it would be appropriate for the Commissioner to exercise his discretion under section 177F to determine that the whole or part of the deduction otherwise allowable shall not be allowable to the taxpayer.

**Is the payment under the Procurement Agreement deductible?**

30. A payment is made to the Underwriters under the Procurement Agreement by the parent company in consideration for which the Underwriters give a signed Payment Direction to the parent directing the Issuer and the Trustee to pay any amounts payable in respect of the Notes to the parent company or as it directs upon the happening of a Payment Direction Event or Dividend Trigger Event. The payment reimburses the Underwriter for its loss on transferring the Income Securities to the Holders.

*Section 8-1 ITAA 1997*

31. We consider that the payment made to the Underwriters by the parent company under the Procurement Agreement is not an outgoing incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

*Section 25-25 ITAA 1997*

32. Subsection 25-25(1) allows a deduction for expenditure incurred by the taxpayer for borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income. It is considered that there is no 'borrowing' in this case so section 25-25 does not apply.

*Part IVA*

33. An alternative response would be that if the payment under the Procurement Agreement is otherwise deductible under section 8-1, Part IVA would have application.

34. We consider Part IVA applies to the Procurement Agreement fee in the same way as we consider it applies to the payments on the Notes.

# Date of effect

35. This Ruling applies to years commencing both before and after its date of issue. It should be noted in this respect that Taxation Ruling No. IT 2411 which was withdrawn from 5 November 1999 has no application to modify this date of effect. In contrast to Draft Taxation Ruling TR 2001/D1 on perpetual notes, the arrangements which are the subject of this Ruling are considered to be convertible notes.

# Explanations

### Description of the arrangements

36. A stapled security arrangement comprises a preference share and a Note, or a preference share and the beneficial interest in a Note.

37. The preference shares are convertible at the option of the parent company after a term of 50 years to ordinary shares of the parent. A formula allows for a discount according to the average weighted market price of the ordinary shares as at the conversion date. Alternatively, they rank *pari passu* with converting preference shares which have been issued by the parent company.

38. The Notes are described in the Prospectus as unsecured perpetual debt obligations of the finance subsidiary. The Notes have no maturity date. They have a face value of $100 each. Under the terms of the Trust Deed, the finance subsidiary Issuer will pay all amounts said to accrue under the Notes directly to Investors unless a 'Payment Direction Event', or a 'Dividend Trigger Event' occurs, pursuant to the terms of the Trust Deed.

#### *Payments to Holders*

39. Holders will be entitled to receive what are described as 'interest payments' payable quarterly in arrears on the Holder's Interest at a floating rate which is the 'base interest rate', based on the 90 day bank bill rate plus a fixed percentage margin above that rate. There is an initial fixed 'interest' rate. The payments are non-cumulative.

40. The periodic payments are described as being subject to various conditions. Payments of 'interest' are said to be 'due and payable' on the Notes, if they would not exceed the parent company's 'Distributable Profits'.

41. 'Distributable profits' means: profits after income tax of the parent for the current financial year less aggregate payments of any

interest and dividends paid during the current year out of those profits, subject to APRA's approval. Alternatively, 'distributable profits' means: profits after income tax of the parent or of the group on a consolidated basis for the previous financial year less aggregate periodic payments on the Notes previously made during the current year and dividends paid by the parent from the previous year's profits, subject to APRA's approval. In one arrangement the Issuer has the discretion to determine what constitutes 'Distributable Profits' subject to APRA's approval. (APRA requires in its current guidelines on capital adequacy for Tier 1 instruments that payments made to fund such capital be paid from current year profits).

42. A payment is not to be made if the payment would cause the parent company to be in breach of APRA's then current capital adequacy guidelines.

43. Under one arrangement the right to the periodic payments is subject to the exercise of the Directors' discretion to stop the payment. The payments are to be made on a pro-rata basis, in proportion to any dividends payable during the immediately following half year with the preference shares and any other preference shares ranking equally.

44. The periodic payments which are said to have 'accrued' but which are not payable because they would exceed Distributable Profits, are deemed, after the relevant 'Interest Payment Date', never to have accrued and never to be payable.

45. If the Note Issuer does not make a payment which is said to have 'accrued', the parent financial institution may not then pay any dividends on its shares which rank *pari passu* with, or junior to, the preference shares stapled to the beneficial interest in the Notes unless and until four consecutive payments on the Notes, or dividends on the preference shares stapled to the beneficial interest in the Notes, have been paid, or the Note Issuer has paid an 'Optional Interest Payment'. An Optional Interest Payment may only be payable if the aggregate amount of the payment would not exceed the parent's Distributable Profits, or if the payment is approved by APRA.

*Performance Guarantee*

46. The parent company provides a Performance Guarantee to investors in respect of the finance subsidiary's obligation to make the periodic payments which are said to be 'due and payable' under the Notes in accordance with the conditions of the Notes and which are not paid by the subsidiary Issuer. In the event of liquidation of the parent company, the liability under the guarantee is subordinated to all claims of creditors.

*Redemption*

47. The stapled securities are redeemable at the option of the parent company only, or on the happening of certain events. The Holder has no right to directly enforce the terms of the security. The Prospectus states that a Holder is not a creditor of the Issuer and has no rights to sue or otherwise make a claim for payment of a debt owing to the Holder, but only to enforce its rights against the Trustee under the Deed. Holders have no ability to require the repayment of any money paid for the Income Securities, and can attempt to obtain repayment only by way of selling the security on the ASX. Under one arrangement, the Prospectus states that investors will have no right to require the parent company to repay the money originally paid for the Income Securities, except by way of a return of capital on the preference shares in a winding up of the parent company. Neither the Trustee nor the investors are said to be entitled to any amounts in respect of their Holder's Interest on the winding up of the issuer of the Notes.

48. The Trust Deed provides to the effect that Notes *may* be redeemed at the option of the Issuer at their 'Redemption Amount' (the 'principal' amount plus 'accrued interest,' if any) after 5 years from the date of issue subject to APRA's approval, or on the happening of certain tax or regulatory events. A *'tax event'* includes a judicial decision, any official administrative pronouncement, published or private ruling, regulatory procedure, notice or announcement, or amendment of the law by which the parent or the finance subsidiary would be exposed to an increase in its costs in relation to the Income Securities, the Notes or the preference shares. A *'regulatory event'* is an event by which changes in laws, or regulations or directives, orders, guidelines etc of APRA or other central bank or governmental authority, mean that there is a risk that the parent company, or the entity holding the banking license, would not be entitled to treat the stapled securities (or the preference shares) as 'Tier 1 Capital' for the capital adequacy requirements of APRA. Redemptions are always made subject to APRA's approval.

49. If the Notes are redeemed at the option of the Issuer or for tax or regulatory reasons the parent may also redeem or buyback the preference shares, but in this case, the preference shares **must be redeemed for no consideration.**

50. An event, called a 'Payment Direction Event' (or 'Dividend Trigger Event') activates the Payment Direction to the parent company given by the Underwriters pursuant to a 'Procurement Agreement'.

51. The parent company pays the Underwriters $100 (per stapled security) in consideration of which the Underwriters give the parent company a signed Payment Direction. The Payment Direction

authorises and directs the Trustee to pay (and directs that the Issuer pays) to the parent company or at its direction all 'Moneys Owing' in respect of the Notes which are said to become 'due and owing' after a Dividend Trigger Event. The $100 paid to the Underwriters reimburses them for the loss they incur when they on-sell the stapled securities to the investors under the Prospectus for $100 (having acquired them initially for $200).

52. The following are examples of Payment Direction Events or Dividend Trigger Events:

- a Liquidation Event occurs in relation to the finance subsidiary or the parent financial institution;
- the finance subsidiary or the parent financial institution is unable to pay its debts within the meaning of the Corporations Law;
- APRA determines that the parent financial institution has a Tier 1 Capital Ratio or a Total Capital Adequacy Ratio less than certain expressed percentages.

53. Under one arrangement, non-payment of the periodic payments said to be 'due and payable' under the Note is a default in the payment of any monies said to be 'Moneys Owing' in respect of a Note, so as to constitute a Dividend Trigger Event. The Issuer may then redeem all of the Notes at the Redemption Amount; payment is made to the parent company or as that entity directs.

54. Under a similar arrangement, non-payment of the periodic payments on the Notes by the Issuer means that the Trustee can enforce the obligation of the Issuer to make the payments, or call on the Guarantor. However, non-payment is not a default so as to give rise to a Payment Direction Event, and such an event itself does not oblige the Issuer or the parent company to redeem the Notes or the preference shares in any case.

55. A Payment Direction Event includes the giving of notice by the parent company to the Trustee *at any time* that it requires all payments of 'interest' and 'principal' on the Notes to be paid to it as they become due, and not to investors.

*Ranking*

56. The right of the Trustee to claim against the Issuer of the Note and against the parent company for non-payment of the periodic payments on the Notes is subordinated to all other creditors and in the case of a claim against the parent company under the Performance Guarantee, ranks equally with claims of preference shareholders.

57. Neither the Trustee nor the Holders have the right to recover the 'principal' amount of the Notes in a winding up of the Note issuer. Such an event is a Payment Direction Event or a Dividend Trigger Event and the Holders will only have a right to a return of capital on their preference shares in a winding up of the parent, subject to claims of all creditors and *pari passu* with converting preference shareholders.

58. The Trust Deed refers to 'Subordination' in terms of the right of the Trustee to be paid the 'Moneys Owing on a Note when due' as subordinated to the claims of all other creditors of the Issuer. 'Moneys Owing' in respect of a Note is defined as 'its outstanding principal amount, any interest payable on it and any other moneys payable in respect of it'. However, the Notes are undated and non-payment of 'interest' is not an event of default so as to trigger a winding-up. It merely in one case constitutes a Dividend Trigger Event so that the 'principal' becomes repayable to the parent, or at the parent's direction.

59. If a Payment Direction Event or Dividend Trigger Event occurs, the Trustee is directed to act solely in accordance with the directions of the parent company in relation to the exercise or non-exercise of any rights under the Notes and any Moneys Owing which become due after that date (including any moneys payable under the Performance Guarantee after a Payment Direction Event has occurred).

*The Preference Shares*

60. If a Payment Direction Event or a Dividend Trigger Event occurs, the Preference shares will become dividend paying. Payment of dividends is subject to conditions similar to those applying to the periodic payments on the Notes; that is, dividends are payable at the same rate and subject to Distributable Profits of the parent company or of the group. Payments are made semi-annually. Payment of dividends is subject to the exercise of the Directors' discretion. Dividends are non-cumulative. The preference shares have only limited voting rights.

61. Provided that no Dividend Trigger Event has occurred, the preference shares which are stapled to the beneficial interests in the Notes may be redeemed by the parent, at its option after five years from the date of issue or, if a regulatory event or tax event has occurred, for no cash consideration, subject to APRA's approval. In both cases, redemption of the preference shares may only be made by the parent company if at the same time the Issuer redeems the Notes stapled to the preference shares for the Redemption Amount.

62. If a Dividend Trigger Event has occurred so that the Notes have become payable to the parent company or at its direction, the preference shares may be exchanged (that is, redeemed, bought back, through a reduction of capital, or a combination of these events) by the parent at the 'Exchange Amount' (which is the issue price of the preference share plus any dividends currently accrued), at its option.

63. If no Dividend Trigger Event has occurred, after a term of 50 years, the parent may elect to convert the preference shares to ordinary shares of the parent, under a formula which allows for a discount of 5% to the daily weighted average sale price of fully paid ordinary shares in the parent during the 20 trading days prior to the conversion date.

64. Under one arrangement, the preference shares may, subject to APRA's approval, be redeemed or bought back at any time for the 'Redemption Price'. Prior to a Payment Direction Event occurring, the Redemption Price is nil. If a Payment Direction Event has occurred, with the result that the Preference Share has become dividend paying, the Redemption Price is the issue price of the share ($100) plus any dividend payable in respect of the most recent payment date excluding the redemption date.

65. In the event that the parent company Issuer of the preference shares is wound up, holders of preference shares rank equally with holders of converting preference shares and other preference shares as issued under the arrangement for a return of capital. They are subordinated to all other creditors and other liabilities of the parent company issuer.

*Use of the Funds*

66. The funds raised by the issue of the Income Securities are said to form part of the capital of the Group. The proceeds from the issue will be used to further strengthen the parent company's long term funding position. The capital may be classified as Tier 1 Capital of the parent or of the banking subsidiary within the group, for regulatory purposes. The instrument is perpetual and subordinated. Besides on-lending within the group, the funds may be used to subscribe for equity within the group. If the group member which is capitalised is the entity which holds the banking license, the capital will count as Tier 1 capital of that entity.

67. The stapled securities have the advantage that they allow capital to be raised more cheaply by the company, as Tier 1 capital which increases the bank's capital adequacy ratio is viewed favourably by the rating agencies. While the Notes are not equity, their issue in conjunction with the parent company's issue of fully

paid preference shares enables the arrangement as a whole to be classified as Tier 1 capital.

*Accounting Treatment*

68. Under one arrangement, the accounting treatment for the instrument is that in the accounts of the subsidiary which issues the Notes, the Notes will be treated as a liability and an 'interest' expense will be recorded for the Note 'interest'. The same accounting treatment will be adopted by group entities to which the Issuer on-lends the funds.

69. On a Group consolidated basis, however, the preference shares will be recorded as equity in the balance sheet and the 'interest' expense reclassified as dividends on consolidation.

**Are the periodic payments deductible under the positive limbs of section 8-1 ITAA 1997?**

70. This question requires a consideration of the principle reviewed by Professor Ross Parsons in *Income Taxation in Australia*, LBC, 1985 at paragraphs 6.291 – 6.302, that a distinction needs to be made between the expenses of deriving income and the application of income derived:

> 'A payment to discharge an obligation which arises because of acts done or omitted in the process of deriving income may be sufficiently connected. But a payment to discharge an obligation which arises because a derivation of income has occurred is not sufficiently connected.'

71. The decisions of the High Court in *DCT (WA) v Boulder Perseverance* (1937) 58 CLR 223 (*Boulder Perseverance*) and in *FC of T v The Midland Railway Co of Western Australia Ltd* (1951) 85 CLR 306 (*Midland Railway*) are illustrations of that principle. Neither of those cases concerned the issue of perpetual notes by a company.

72. The members of the High Court (Latham CJ, Dixon J and McTiernan J) in *Boulder Perseverance* at 234 in upholding the disallowance of a deduction by the Commissioner of a distribution of profits in excess of the 10% per annum coupon on certain securities said:

> 'The nature of the contract in the present case appears to be clear enough. The parties adopted a contract for the division between them of the ultimate net profit made by the company. It is more than a payment contingent upon the making of net profits and proportional to their amount. It is a payment of

> part of the net profits under that description. **What is important, however, is the fact that the fund which under the contract the company divides with the debenture or note holders is the fund of profit cleared of all other charges whatsoever, with the contingent exception of the tax or taxes thereon.**' (emphasis added)

73. In *Midland Railway* Dixon J considered *Boulder Perseverance* and said:

> 'The issue is not whether the payment when made possessed the character of interest on borrowed money, borrowed for the purpose of the business. It is not whether the obligation is pursuance of which it was paid had taken this or that form… Further it is not decisive of the issue under s51(1) that it was paid or payable out of profits, that is so long as it was not payable out of the precise fund called by the Act taxable income.'

74. In the stapled security arrangements, periodic payments to the Holders are made contingent on the existence (and extent) of profits after tax of a current or previous year, or the payments are contingent on the profits (after tax) of associates of the Issuer.

75. There are two views as to the application of the principle expressed above. One view is that the periodic payments are not deductible, because the obligation does not arise until there are distributable profits; they are an application of income derived and are not made to earn assessable income. An alternative view is that they are deductible, if they are merely contingent on net profits (and do not diminish those profits) of the entity. But in any event the application of the principle expressed above depends on the facts of the particular case.

76. Given our views on the application of the negative limb of section 8-1 to these arrangements, it is not necessary to decide the issue but we will consider each case on its merits.

77. In the event that a deduction is denied for the periodic payments under the positive limbs of section 8-1 as being an application of income derived, it is not necessary to consider the remaining question of whether the payments are on capital account.

### Are the periodic payments made by the Issuer finance subsidiary on the Notes payments of interest on a loan?

78. In determining this question, issues to be addressed include:

- the form of the transaction and the labels attached to it by the parties;

- the nature of interest and the nature of a loan; and
- what the transaction entered into by the parties by its terms effects.

### *The form of the transaction and the labels attached to it by the parties*

79. In *Australia and New Zealand Savings Bank Limited v FC of T* 93 ATC 4370 at 4390; (1993) 25 ATR 369 at 392 ('*ANZ Savings*'), Hill J, in determining whether the transaction under examination was one of a loan or an annuity, referred to *NM Superannuation Pty Ltd v Young* (1993) 113 ALR 39 at 56 and said that:

> 'the label used by the parties will not be determinative…, [but] it does not follow that the label used between the parties will be totally irrelevant.'

80. The form of the payment is not determinative: see Dixon J in *Midland Railway* (supra).

81. Merely because the agreements evidencing the Note issue have been drafted to give the Notes the gloss of a loan using labels associated with a loan such as 'moneys owing', 'principal', 'interest', 'redemption amount' and 'debt obligation', does not necessarily characterise the transaction as a loan.

### *The nature of interest; the nature of a loan*

82. Halsbury's Laws of England, 4th Edition, Volume 32, paragraph 106, states that **'interest is the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another'** (see the Canadian case of *Re Farm Security Act 1944* [1947] SCR 394 at 411; and *Dunn Trust Ltd v Feetham* [1936] 1 KB 22, CA; *Bennett v Ogston (Inspector of Taxes)* (1930) 15 TC 374; *Bond v Barrow Haematite Steel Co* [1902] 1 Ch 353; *Riches v Westminster Bank Ltd* [1947] AC 390, [1947] 1 All ER 469, HL.)'

83. Interest was described by Rowlatt J in *Bennett v Ogston* (Inspector of Taxes) (1930) 15 TC 374 at 379 as being a **'payment by time for the use of money'.** It has been said that this 'definition' highlights the two requirements which must normally be satisfied for a payment to amount to interest, namely:

(a) there must be a sum of money by reference to which the payment is to be ascertained (which might loosely be called the principal sum or the principal debt); and

(b) that sum must be a sum which is due to the person entitled to the interest, unless the right to the interest

> has been assigned to a third party. ("Interest", King J.C., Taxation in Australia, Vol. XV, No. 1, July 1980 at p.3).

84. That interest is a charge for the use or enjoyment of the principal sum for a fixed period of time was commented upon by Bowen CJ and Burchett J in *Australian National Hotels Limited v FC of* T 88 ATC 4627 at 4633; (1988) 19 ATR 1575 at 1582 (*Australian National Hotels)* where they considered the nature of capital committed to a business by means of, *inter alia*, a loan:

> 'If the capital is raised by loan, an investment of the borrowed moneys in a business will ordinarily remain an investment of capital, and the same consequences will follow. **But there is a special feature of loan capital, which flows from the ephemeral nature of a loan...'** (emphasis added)

85. That passage of the judgment of Bowen CJ and Burchett J in *Australian National Hotels* was referred to with approval in *Steele v FCT* 99 ATC 4242 at 4248; (1999) 41 ATR 139 at 148 ('*Steele'*). Gleeson CJ, Gaudron and Gummow JJ described the character of interest as being a recurrent payment to secure the use for a limited term of loan funds:

> 'As was explained in *Australian National Hotels Ltd v FCT*, interest is ordinarily a recurrent or periodic payment which secures, not an enduring advantage, but, rather, the use of borrowed money during the term of the loan. According to the criteria noted by Dixon J in *Sun Newspapers Ltd v FCT* it is therefore ordinarily a revenue item. This is not to deny the possibility that there may be particular circumstances where it is proper to regard the purpose of interest payments as something other than the raising or maintenance of the borrowing and thus, potentially, of a capital nature**. However, in the usual case, of which the present is an example, where interest is a recurrent payment to secure the use for a limited term of loan funds**, then it is proper to regard the interest as a revenue item…' (emphasis added)

86. A debt **is moneys outstanding to be repaid at a fixed or determinable time or on demand**: 'Chitty on Contracts', 27th ed. 1994, para 36-202.

87. One feature of a loan therefore is the use of the funds for a temporary period; another feature of a loan is the requirement to repay those funds at the end of that period or on demand.

88. The stapled security arrangements lack both elements referred to above. The term of the Notes is perpetual, i.e., it is undated; and the Issuer and the parent company have the use of the funds raised for an indefinite period of time so that the capital raising lacks the

ephemeral nature of a loan. The second element missing from the Note issue is that the Issuer is under no obligation to repay the funds raised. The Issuer has the option, but not the obligation to repay.

89. In *FC of T v Radilo Enterprises Pty Ltd* 97 ATC 4151 at 4161; (1997) 34 ATR 635 at 646 (*Radilo*) the joint judgment of Lehane and Sackville JJ refers to Dr Pannam's description of a loan of money:

> 'A loan of money may be defined, in general terms, as a simple contract whereby one person ('the lender') pays or agrees to pay a sum of money in consideration of **a promise by another person ('the borrower') to repay the money upon demand or at a fixed date**. The promise of repayment may or **may not be coupled with a promise to pay interest on the money so paid. The essence of the transaction is the promise of repayment**. As Lowe J put it in a judgment delivered on behalf of himself and Gavan Duffy and Martin JJ: **"Lend" in its ordinary meaning in our view imports an obligation on the borrower to repay**." [*Ferguson v O'Neill* [1943] VLR 30, at 32.] Without that promise, for example, the old *debitatus* count of money lent would not lay. **Repayment is the ingredient which links together the definitions of 'loan' to be found in the Oxford English Dictionary, the various legal dictionaries and the text books. In essence then a loan is a payment of money to or for someone on the condition that it will be repaid**.
>
> CL Pannam, *The Law of Money Lenders in Australia and New Zealand* (1964) at 6. See also *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* 9 ACLC 324, at 357-358; [1922] 2 VR 279, at 321-323, per Ormiston J.' (emphasis added)

90. A debt instrument generally gives the holder the right to sue for recovery of the principal sum in debt if the issuer fails to make the scheduled payment: see *Charles E. Curry 43* TC 667, 686 16 (1965); *Luden's Inc. v United States* 196 F. Supp 526, 633 (E.D Pa. 1961).

91. In the United States, the absence of a fixed maturity date has been held generally to constitute conclusive evidence that the instrument is not debt: *Texas Farm Bureau v United States* 725 F.2d 307, 313-14 (5th Cir. 1984); *Jewel Tea Co v United States* 90 F. 2d 451, 453 (2d Cir. 1937). (See also Plumb, *The Federal Income Tax significance of Corporate Debt: A Critical Analysis and a Proposal* 26 Tax L. Rev. 369, 625-32(1971) at 413.) A small minority of cases have treated securities as debt when they were to mature only upon a default in the payment of interest: see *Helvering v Richmond* F.&P.R.R ,90 F. 2d 971 (4th Cir. 1937).

92. In the arrangements described, the Issuer does not have an obligation to repay the 'principal' sum 'borrowed'. The Issuer has **an option** to redeem the Notes at any time after 5 years from the date of issue, or on the happening of certain regulatory and tax events, subject to APRA's approval.

93. If there is a default in the payment of 'interest', or upon insolvency of the Issuer or the parent company, or a liquidation, (or, in one case, purely at the discretion of the directors of the Issuer) the Note 'principal' becomes payable to the parent company, and the investor's residual entitlement is to a return of capital on the preference shares, or subsequently on the ordinary shares to which the preference shares may convert at the option of the issuer after 50 years. No guarantee is given in respect of repayment of 'principal'.

94. A Dividend Trigger Event activates the Payment Direction, and the Trustee comes under the control and direction of the parent company in respect of any 'Moneys Owing' that become due after the Dividend Trigger Event. Likewise, the Moneys Owing under the Notes after that date become payable to the parent company.

95. Non-payment of 'interest' is a Dividend Trigger Event in one of the arrangements but, although the Trustee can enforce its rights to payment of 'interest' said to be 'due and payable' before that Event against the Issuer, there is no right to recover the 'principal' in such an Event. The guarantee, which is a subordinated obligation to all creditors of the parent, is given in respect of 'interest' 'due and payable' on the Notes only. A winding up of the Issuer is a Dividend Trigger Event, and a Payment Direction Event. Payment of 'interest' which falls 'due' under the Notes after such an Event, and the 'principal', are required **to be paid to the parent company, or at its direction.** The preference shares become dividend paying, but are exchangeable, or redeemable, or convertible as the case may be, only at the option of the parent.

96. In the event of a winding up of the parent, Holders of Income Securities will only be entitled to receive a distribution in respect of the preference shares and will only have a right to receive a return of capital after all creditors and other liabilities of the parent have been paid, but (unless the preference shares are already converted into ordinary shares in the case of one arrangement) they will rank ahead of the ordinary shareholders of the parent and equally with the holders of the parent's existing converting preference shares.

97. If a winding up of the parent occurs after conversion into ordinary shares, Holders of the Income Securities would hold ordinary shares and would rank equally with existing ordinary shareholders, behind all creditors and behind the holders of any preference shares in the parent then on issue.

***What is the legal relationship between the parties evidenced by the transaction?***

98. The legal relationship between the Issuer and the Trustee acting on behalf of the Noteholders evidenced by the Prospectus and Trust Deed is not that of a debtor-creditor relationship. There is no obligation to repay 'principal', and no mechanism of the Holders to enforce repayment of the 'principal sum' in the event of default of payment of 'interest' (which is expressed to be non-cumulative in any case), insolvency or liquidation. If the Holder's investment is ultimately represented by the preference share, the 'principal' of the Note having become payable to the parent, the preference share itself is not liable to be redeemed at the option of the Holder. It may be redeemed at the parent's option, and may be liable to be converted, at the parent's option, after fifty years, into fully paid ordinary shares in the parent, under a formula. As the Full Federal court found in *Radilo*, such a facility of conversion does not constitute a debtor-creditor relationship.

99. The relationship between the Holders and the Issuer is more akin to that of a company and a perpetual preference share holder. The periodic payments may be seen to be analogous (in economic equivalence terms) to the payment of fixed dividends on preference shares, and indeed, as a direct substitute for them while the Note is extant. In one arrangement, periodic payments on the Notes are subject to the Directors' discretion, and paid *pari passu* with dividends on preference shares ranking equally with the Notes. While the Notes are 'interest' paying, the preference shares stapled to the Note do not pay dividends. Upon a Dividend Trigger Event, the preference shares are liable to pay dividends, at the same rate as interest. The rights of preference shareholders are not protected, in the same way as debenture holders. Professor Gower (*Modern Company Law*, 4th Edition, 1979, at 419) has said:

> 'But though they share the disadvantages of debenture holders they lack their advantages. They can only receive a return on their money if profits are earned and dividends declared, they rank after creditors on a winding-up, and they have less effective remedies for enforcing their rights. Suspended mid-way between true creditors and true members they get the worst of both worlds.'

100. In the circumstances of the arrangements, the Holders of the securities are not entitled to 'interest' whether or not the company is profitable. Even if there are sufficient profits so that the periodic payments are said to be 'due and payable', the directors in one instance have the right to stop the payment and that is a condition of payment. Payments which are not considered 'due and payable' in accordance with the conditions of payment are deemed never to be

'due and payable', and as such, cannot be claimed under the guarantee. The right to payments if considered 'due and payable' and unpaid prior to a Payment Direction Event or Dividend Trigger Event may be enforced at the suit of the Holders but is a subordinated claim on a winding-up.

101. In addition, the Income Security is transferred to investors for a consideration of $100, equal to the face value of the fully paid preference share. The investors also obtain under the structure the interest in a Note which has a face value of $100. It is arguable that the investors have therefore allocated no consideration for the acquisition of that beneficial interest. It is doubtful whether the subscription for $100 is, at law, a loan. The preference share is not a bonus share in that it has not been issued in relation to an original shareholding in the parent company. The Holder of the Income Security does not take the preference share on trust.

102. Given that no formal allocation of consideration has been given to the components of the stapled security, having regard to the entirety of the contractual arrangement between the Holders and the Issuers, the periodic payments may be viewed as a cost to the parent company of raising equity. Under one arrangement, the terms of the preference shares are imported into the conditions governing the issue of the Notes. That is, the preference shareholder can be taken to subscribe $100 for that share on terms which embrace the collateral transfer of a bond issued by a subsidiary of that entity. On the happening of either a Payment Direction event or a Dividend Trigger Event (which in one case includes the giving of notice by the parent company to the Trustee *at any time*, at its discretion) the principal on the Notes becomes payable to the parent and not to investors. That is, the parent acquires the benefit of the Note, and the net effect of the transaction is the issue of equity by the parent company.

103. Alternatively, the legal relationship in respect of the issue of the Notes, disregarding the stapled preference shares and the interrelationship of the rights and obligations of the Issuers of those instruments, may be viewed as simply that of capital contributed to the Issuer on contractual terms that entitle the Holders to a reward, being the periodic payments. Irrespective of what the exact legal relationship is, it is not one of a debtor-creditor evidencing payments that are interest on a loan.

### Alternative views

104. The terms and conditions in the Trust Deed that govern the issue of the stapled securities give rise to a debtor-creditor relationship between the Issuer and the Holder of the interest in the note stapled to the preference share.

105. The former section 1050 of the Corporations Law provided that notwithstanding any rule of law or equity to the contrary, companies had the power to issue debentures that were irredeemable, or redeemable only on the happening of a contingency, however remote, or at the end of a period, however long.

106. The beneficial interest in the note is a 'unit' of a 'debenture' for the purposes of section 9 and section 1050 of the Corporations Law.

***Response***

107. Section 1050 has been repealed by Schedule 3 Item 57 of the *Corporate Law Economic Reform Program Act 1999*. A company has the power to issue 'debentures': paragraph 124(1)(b) of the Corporations Law (as amended by Act No. 61 1998). 'Debentures' is widely defined in section 9 of the Corporations Law but the term does not include debentures that are irredeemable.

108. The relevant corporate law provisions do no more than make valid instruments which otherwise might be invalid. The description of these instruments as 'debentures' for company law purposes is irrelevant to the characterisation of the outgoing in terms of section 8-1 ITAA 1997. For tax law purposes, the relevant concepts are those referred to in the case law above, as exemplified in the passage in the judgment of Bowen CJ and Burchett J in *Australian National Hotels* where they refer to the 'special features of loan capital which flow from the ephemeral nature of a loan.' See also the passage in *Steele's* case referred to above.

**If the periodic payments satisfy the positive limbs of section 8-1 ITAA 1997 is a deduction for the payments denied under the negative limb paragraph 8-1(2)(a) ITAA 1997 being a loss or outgoing of a capital nature?**

109. It only becomes necessary to consider the negative limbs of section 8-1 ITAA 1997 if it has already been concluded or accepted by hypothesis that one or other of the positive limbs applies (refer the High Court decision in *Steele* 99 ATC at 4247; 41 ATR at 146).

110. This discussion as to whether the payments on the Notes are on capital account proceeds on the hypothesis that a deduction is not denied under the positive limbs of section 8-1 ITAA. That is, on the assumption that the payments on the Notes are an outgoing incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for that purpose.

111. In this regard it is important to note that the negative capital limb in section 8-1 ITAA 1997 is truly an exception to the positive

limbs of section 8-1 ITAA 1997. This was confirmed by Dixon J in *John Fairfax & Sons Pty Ltd v FCT* (1959) 101 CLR 30 at 34.

### *The character or relevance of the periodic payments*

112. The character or relevance of the periodic payments is an important feature to consider when determining whether the payments on the Notes are on revenue or capital account under the negative limb of section 8-1 ITAA 1997. This examination, in the words of Dixon J in *Hallstroms Pty Ltd v FCT* (1946) 72 CLR 634 at 648-9, looks to:

> '…what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process.'

113. Hill, Drummond and Sackville JJ in *FC of T v Email Limited* 99 ATC 4868 at 4872; (1999) 42 ATR 698 at 703 referred to the passage above and stated that this examination:

> '…involves both a consideration of the character of the expenditure and in many cases an examination of the business structure and the operations of the business in the course of which the expenditure has been incurred.'

114. Applying the factors in the above two decisions, the relevant questions to be addressed in determining the character of the expenditure include an examination from a practical and business point of view into:

- the relationship between the Holders and the Issuers;
- the nature of the capital raising; and
- the business structure and operations in the course of which the periodic payments have been incurred.

### *The relationship between the Holders and the Issuers*

115. As addressed earlier, the legal relationship between the Holders and Issuers is not one of a debtor-creditor relationship. From a practical and business point of view, the Holders can only realise their investment in the Notes through trading in the secondary market on the ASX. In respect of the periodic payments on the Notes, the Holders may have *an expectation* that payments will always be made. However, the Issuers have the advantage that they will retain the use of the capital subscribed even in the event that payments are not due and payable. Furthermore, non-payment of payments that are due and payable does not entitle the Holders to recover the amount invested.

### *The nature of the capital raising*

116. The raising of capital through the issue of the stapled securities comprising the beneficial interest in the Note can be contrasted with that of a borrowing under a loan. The joint judgment of Bowen CJ and Burchett J in *Australian National Hotels* 88 ATC at 4633; 19 ATR at 1582 supports this distinction.

117. Given that the character of the capital raised is non-refundable, it has a permanent, rather than an ephemeral nature.

### *The role that the capital raising plays in the business structure and operations*

118. The form of the capital raising, through a special purpose subsidiary set up to issue the Notes as part of the financing arrangement constituting Tier 1 capital, dictates that it is not a recurrent event. It is a one-off event. In addition there is a finite limit required by APRA on the banking group's ability to raise such capital.

119. The funds are treated as equity in the balance sheet of the company on a consolidated basis and the payments are treated as dividends from retained earnings. They represent a permanent and unrestricted commitment of funds to the group and are deeply subordinated, ranking equally with equity issued by the parent. In the circumstances of the banks or some other financial institutions raising capital by the issue of instruments which qualify as Tier 1 capital, the capital has the effect of strengthening the balance sheet of the company. Such capital may allow the issuer to raise other less expensive capital, given that rating agencies view these instruments favourably. Borrowing capacity is increased, which is proportionately represented by the potential increase in Tier 2 capital which the bank is able to hold.

120. An additional effect of a stapled security issue is a non-diluting on the Issuer group's ordinary shareholding. Another is the preservation of franking credits for their ordinary shareholders, thus maintaining the attractiveness to investors in the market of those ordinary shares. This latter point is particularly important in circumstances where the Issuer group's ability to frank is diminishing with increased profits sourced from offshore operations.

### *Determining whether the periodic payments are on revenue or capital account*

121. In determining whether the periodic payments are on revenue or capital account, reliance is not placed upon the characterisation of the payments as being one for the creation or acquisition of an asset, as generally no assets are directly acquired by the Issuers. In any

event, the acquisition of a capital asset does not necessarily mean that the payments that fund that acquisition are on capital account: refer *Steele*.

122. The payments made by Associated Newspapers Ltd in *Sun Newspapers Ltd and Associated Newspapers Ltd v FC of T* (1938) 61 CLR 337 (*Sun Newspapers*) did not, in the words of Latham CJ at 355, 'result in obtaining a new capital asset of a material nature, but they did obtain a very real benefit or advantage for the companies, namely the exclusion of what might have been serious competition'. Latham CJ continues at 355:

> 'When the words "permanent" or "enduring" are used in this connection it is not meant that the advantage which will be obtained will last forever. The distinction which is drawn is that between more or less recurrent expenses involved in running a business and an expenditure for the benefit of the business as a whole: See per Rowlatt J. in *Anglo-Persian Oil Co. Ltd. v Dale* (1932) 145 L.T. at p. 532, where consideration is given to the significance of the word "enduring" in this connection.'

123. The periodic payments under consideration in this Ruling result in an enduring benefit for the taxpayer in the form of the strengthening of the taxpayer's capital structure in the sense explained above.

124. In *Sun Newspapers* at 359-360 Dixon J states:

> 'The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure, or organization set up or established for the earning of profit and the process by which such an organization operates to obtain regular returns by means of regular outlay, the difference between the outlay and the returns representing profit or loss. The business structure or entity or organisation may assume any of an almost infinite variety of shapes and it may be difficult to comprehend under one description all the forms in which it may be manifested…
>
> …But in spite of the entirely different forms, material and immaterial, in which it may be expressed, such sources of income contain or consist in what has been called a "profit-yielding subject", the phrase of Lord Blackburn in *United Collieries Ltd. v. Inland Revenue Commissioners*' (1930) S.C. 215, at p. 220…
>
> …The result or purpose of the expenditure may be to bring into existence or **procure some** asset or **advantage of a lasting character** which will enure for the benefit of the

> organisation or system or "profit-yielding subject." It will thus be distinguished from the expenditure which should be recouped by circulating capital or by working capital.' (emphasis added)

125. In arrangements considered in this Ruling, while the periodic payments will not procure an asset for the taxpayer, they will procure an advantage of a lasting character which will enure for the benefit of the profit-yielding subject, that is, the funds contributed on a permanent basis by the issue of the stapled securities comprising the Note element which will strengthen the taxpayer's capital structure.

126. Dixon J stated at 363 the passage referred to by Hill J in *Smithkline Beecham Laboratories (Australia) Ltd v. FC of T* 93 ATC 4629 at 4634 as 'the classic statement':

> 'There are, I think, three matters to be considered, (1) the character of the advantage sought, and in this its lasting qualities may play a part, (2) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (3) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.'

### *The means adopted to obtain the advantage sought*

127. When addressing the means adopted to obtain the advantage, periodicity or recurrence is merely one matter to consider in determining whether expenditure is on capital account. Gibbs J observed this in his dissenting judgment in *Cliffs International v FC of T* [1978-1979] 142 CLR 140 at 153; 79 ATC 4059 at 4067; (1979) 9 ATR 507 at 515 where he referred to Dixon J in *Sun Newspapers* at 362 who said that recurrence 'is not a test, it is no more than a consideration the weight of which depends upon the nature of the expenditure'.

128. The periodic payments on the Notes can be distinguished from payments of interest on a loan. Interest on a loan is ordinarily due and payable irrespective of the profitability of the borrower. In return for each interest payment the borrower under a loan is entitled to the retention and use of the borrowed money for the period of time to which that interest payment relates. The contractual obligation of the borrower under a loan agreement to pay interest gives rise to the recurrent nature of interest.

129. The means adopted to obtain the advantage of a permanent capital raising through the issue of the stapled securities comprising the Note element, whilst in the form of periodic payments, does not

cover its use or enjoyment for periods commensurate with the payment. The payments are in the nature of instalments of the purchase price of the permanent capital. The advantage is retained irrespective of whether the payments are made.

### *The manner in which it is to be used, relied upon or enjoyed*

130. The capital raised under the stapled securities comprising the Note element is a once and for all injection of capital that strengthens the capital base of the Issuers. The capital may never be repaid to the Holders, who may be left ultimately with a sole investment represented as permanent share capital. In one arrangement, the preference shares may be converted at the option of the parent company issuer or at the elapse of 50 years, to ordinary share capital.

131. It strengthens '*the business entity, structure, or organisation* set up or established for the earning of profit' (by providing permanent capital); the obtaining of the funds through the issue of the stapled securities is not part of the process by which the company operates to obtain regular returns: Dixon J in *Sun Newspapers* at 359.

132. Holders subscribe permanent capital to the company and receive by way of a return a sum based upon the amount subscribed. Capital may be contributed to a company on contractual terms as a contribution to the capital base of the company (see Dixon J in *Midland Railway* at 316).

### *The character of the advantage sought*

133. The character of the advantage sought by the Issuers of the stapled securities comprising the Note elements is the raising of permanent capital which strengthens the capital base of members of the group. It is an expenditure for the benefit of the business as a whole. It strengthens the business entity, structure, or organisation set up or established for the earning of profit. What the Issuers' seek to achieve in making the periodic payments is not the use of the funds invested for a period of time referable to the payment but the permanent acquisition of the funds. This can be distinguished from **the ephemeral nature of a loan**, the payment of interest thereon being made **to secure the use for a limited term of loan funds.** As Gleeson CJ, Gaudron and Gummow JJ in the High Court in *Steele* observed at 99 ATC at 4248; 41 ATR at 148:

> 'As was explained in *Australian National Hotels Ltd v FCT*, **interest is ordinarily a recurrent or periodic payment which secures, not an enduring advantage, but, rather, the use of borrowed money during the term of the loan**. According to the criteria noted by Dixon J in *Sun Newspapers*

*Ltd v FCT* it is therefore ordinarily a revenue item. This is not to deny the possibility that there may be particular circumstances where it is proper to regard the purpose of interest payments as something other than the raising or maintenance of the borrowing and thus, potentially, of a capital nature**. However, in the usual case, of which the present is an example, where interest is a recurrent payment to secure the use for a limited term of loan funds**, then it is proper to regard the interest as a revenue item…' (emphasis added)

***Identifying the relevant factors***

134. In determining whether the periodic payments on the Notes are on revenue or capital account it is appropriate to adopt the line of reasoning (as opposed to relying upon the facts or decision) used by Jacobs J in *Cliffs International v FC of T* 142 CLR at 173-175; 79 ATC at 4078; 9 ATR at 529 to first identify, then secondly to weigh-up the relevant factors.

135. The factors derived from *Sun Newspapers* relevant to what the periodic payments on the Notes are calculated to effect from a practical and business point of view, include:

a) the payments are made to raise permanent capital, i.e., a permanent contribution to the capital of the Issuer and the group. The capital is liable to be ultimately represented in the hands of the Holders as preference shares, which may in one case be converted at the option of the parent or after 50 years to ordinary shares. These features can be distinguished from the ephemeral nature of a loan;

b) the payments are calculated at above-market rates of interest on ordinary debt. This reflects the higher cost of acquiring permanent capital over the cost of raising term debt. In addition there is recompense for the contingent nature of the obligations;

c) the payments may be viewed as recurrent;

d) for banks, some financial institutions and their consolidated groups, the payments give rise to a strengthening of the balance sheet where the capital raised is treated by the bank prudential regulator as Tier 1 capital; it is core capital that is the cornerstone of a bank; it strengthens '*the business entity, structure, or organisation* set up or established for the earning of profit;'

e) the capital raised on the stapled securities is treated as equity for accounting purposes and shareholder's funds in the balance sheet (on a group basis) and improves the capital base, maturity profile and gearing levels;

f) the effect in (d) may result in the Issuer being able to raise ordinary debt at a cheaper rate due to improved credit ratings.

### *A weighing-up of the factors*

136. The predominant factors are considered to be those listed in a), b), c), d) and e). The recurrent nature of the payments (factor c)) points to the payments being on revenue account, despite the potential lack of periodicity. Against this an important factor is factor b). The obligation to make the payments is contingent; the arrangements secure a permanent advantage, whether or not the payments are paid.

137. Of those factors, all but factor c) suggest the character of the advantage sought by the Issuers in the making of the payments is one of an enduring advantage, one that characterises the payments as being on capital account.

### *Conclusion*

138. The main purpose of issuing stapled securities comprising the Note element is to raise capital for an indefinite duration, thus obtaining a permanent and enduring advantage. The capital raising does not possess that 'special feature of loan capital, which flows from the ephemeral nature of a loan.' This advantage has the effect of strengthening the capital base of the Issuer and the group and thus the balance sheet. The cost of securing and retaining the use of the capital sum for the business is an outgoing, which although periodic, is of a capital nature for the purposes of the exclusion in subsection 8-1(2) ITAA 1997.

## Do the convertible note provisions of Division 3A of Part III of the ITAA 1936 Act apply to deny the interest deduction?

139. If, in the alternative, the payments on the Notes are to be considered as payments of interest on a loan to the Issuer, the application of the convertible note provisions to the payments made on the stapled securities arises.

### *The Structure*

140. As described above, the Income Securities comprise:

- a beneficial interest in a Note issued by the special purpose subsidiary, a wholly-owned subsidiary of the parent; and
- a fully paid converting preference share issued by the parent.

141. The operative provision of Division 3A of Part III is subsection 82R(3) which provides:

> 'An outgoing consisting of interest, or a payment in the nature of interest, under a convertible note to which this section applies shall be deemed not to be an allowable deduction from the assessable income of the company.'

142. Subsection 82R(1) provides that:

> 'Subject to sections 82S and 82SA, this section applies to a convertible note issued by a company….. '

143. In this case, the relevant company is the Issuer of the Notes claiming the deduction for payments made on the Notes as issued to the Trustee to be held on behalf of the Holders.

***Is the stapled security a 'convertible note'?***

144. A 'convertible note' is defined in subsection 82L(1) to include a 'Note issued by a company that provides, whether in pursuance of or by virtue of a trust deed or otherwise:

> (a) …
>
> (b) that the holder or owner of the note is to have, or may have, any right or option to have allotted or transferred to him or to some other person, or for him or some other person otherwise to acquire, shares in the capital of the company or of some other company.'

145. The 'notes' in this respect are the Notes issued by the subsidiary company to the Trustee to be held on trust for the Holders and includes the interest in the Note held by the Holder of the Income Securities. Subsection 82L(5) provides that a reference in the Division to the terms applicable to a convertible note shall be read as including a reference to terms that apply in pursuance of or by virtue of a trust deed.

146. 'Note' is defined in subsection 82L(1) as follows:

> '"Note" means a note or other instrument issued by a company that evidences, acknowledges, creates or relates to a loan to the company.'

### *Is there a 'Loan'?*

147. 'Loan' is defined as follows:

> '"loan", in relation to a company, means:
>
> (a) a loan, advance or deposit of money to or with the company;
>
> (b) money subscribed to the company; or
>
> (c) any other form of debt or liability of the company whether secured or unsecured and whenever redeemable, repayable or to be satisfied.'

148. The definition of 'loan' in subsection 82L(1) is wide. In particular, we consider upon the alternative assumption that the monies subscribed in respect of the Note interest is a loan, that paragraph (a) applies; or that paragraph (b) of the definition which refers to 'money subscribed to the company' may apply.

149. Such an interpretation would aid the intention of the Division as referred to in the Explanatory Memorandum introducing section 82L of Division 3A as:

> 'On the view that interest paid on convertible notes - on the terms on which the notes were then being issued - had generally more in common with non-deductible dividends on deferred shares than deductible interest on borrowed money, the Principal Act was amended in 1960 to provide that interest incurred by a company on convertible notes was not to be deductible from the assessable income of the company where the notes were issued after 15 November 1960.'

150. The stapling device purports to enable the taxpayer to achieve on a group basis a lower cost of issuing capital. If the parent company were to issue preference shares and nothing more, the dividends on those shares would not be allowable deductions. By stapling the preference share to an interest in a Note issued by its subsidiary, the effect of the combined security is to substitute payments of interest on a Note for non-deductible dividends on the preference shares. The preference shares do not pay dividends during the effective life of the Note; if however, certain events transpire which constitute Dividend Trigger Events or Payment Direction Events under the terms of the Trust Deed, dividends paid to the Holders at the same rate and on a similar basis, will be substituted for payments of interest on the Notes. Economically, the instruments are equivalent; one substitutes for the other. Such an arrangement infringes the policy of the legislation as outlined in the Explanatory Memorandum.

151. We acknowledge that the security does not fall within the definition of 'convertible note' in paragraph 82L(1)(a). That is, the Note (or the interest in the Note) is not liable to be converted into

shares in the capital of the Issuer (or of some other company, relevantly, the parent which has issued the preference shares). Nor is the Note to be redeemed, repaid or satisfied by the allotment or transfer or acquisition of shares, or repaid or satisfied by application in or towards paying-up unpaid shares.

152. The Note may be redeemed for face value in certain circumstances, or it may become payable to the parent company or at its direction upon the operation of the Payment Direction upon a Dividend Trigger Event or Payment Direction Event. No amount of the Note is to be applied in paying up the preference shares stapled to the Note, which are issued as fully paid.

153. To that extent, the Note has an independent operation, or life, from the preference share. In *Network Finance Ltd v FCT* 76 ATC 4336; (1976) 6 ATR 589 (*Network Finance),* Sheppard J held that the convertible note and the loan agreement each related to an entirely different indebtedness and could not be read together to have the 'combined effect' of a convertible note. (That case is authority for the proposition that if one of the instruments on its own is a convertible note then subsection 82L(2) cannot operate).

154. In this case, we do not seek to maintain that the combined effect of the instruments (the preference shares and the interest in the Note) is a 'convertible note' pursuant to subsection 82L(2). The instruments do not relate each to an entirely different indebtedness, as the shares are fully paid: see *Network Finance* per Sheppard J.

155. In the facts of the arrangements considered, it is legally impossible for one to be entered into without the other, due to the stapling device effected by the Trust Deed and the terms and conditions of the instruments. However, we acknowledge that the preference share is not an 'indebtedness'. The facts of *Network Finance* concern a convertible note and a loan each of which evidenced a separate indebtedness. Those are not the facts of the arrangements subject of this Ruling.

156. However, we consider that the stapled security falls within paragraph (b) of the definition in subsection 82L(1).

157. It is a condition of subscribing for the Notes as provided for in the Trust Deed governing the issue of the Notes that upon the issue of a Note to the Trustee, the beneficial interest in that Note will become stapled to an equal number of preference shares issued to the Initial Holder. The Note and the preference share together constitute a 'Stapled Security'. Pursuant to the terms of the Trust Deed, the beneficial interests in the Notes cannot be transferred, assigned, or otherwise dealt with separately from the preference share which forms part of the stapled security.

158. The provision is also expressed in the Terms of Issue of the preference shares. Upon the issue of preference shares to the Initial Holder and the registration of that person in the Register as the Holder of the beneficial interests in the Notes, each preference share will become stapled to a beneficial interest and the preference share and the beneficial interest will together form an Income Security.

159. In one arrangement, the Conditions attaching to the Note, the beneficial interest in which is stapled to a preference share, are said to constitute part of the Terms of Issue of the preference share to which it is stapled and are binding on Holders as members of the company.

160. The Terms of Issue provide that no transfer of a preference share is to occur from a transferor to a transferee without the beneficial interest in the Note which is stapled to it being also transferred at the same time from the same transferor to the same transferee.

161. It is apparent from the governing documents, that a subscriber who acquires a beneficial interest in a Note under the Offer contained in the Prospectus, or a subsequent transferee has a ‘right to have allotted or transferred to him or to some other person, or for him or some other person otherwise to acquire, shares in the capital of the company or of some other company’.

### *The Operation of section 82SA*

162. The operative provision subsection 82R(3) is to be read subject to section 82SA, which provides that section 82R does not apply in relation to a convertible Note issued by a company where various requirements are satisfied.

163. The width of the wording in subsection 82L(1) is not repeated in section 82SA.

164. In particular, subparagraph 82SA(1)(d)(i) requires that an **option** (called in the section an ‘option to convert’) is given to the holder or owner of the convertible note to have allotted or transferred to him shares in the capital of the company or of another company.

165. ‘Right’, as it appears in paragraph 82L(1)(b) has a wider import than the term ‘option’.

166. The ‘Initial Holder’ under the Subscription Agreement, or the subscriber for a stapled security under the Offer held out in the Prospectus, has an enforceable right to acquire the shares, but it **must** take them; the investor cannot elect to have the shares allotted or transferred to him (in lieu of repayment of the Note consideration). Subparagraph (1)(d)(ii) of the tests in section 82SA is also subsequently failed on that basis, as are subparagraphs (ii), (iv), (v) (vii), (viii), (ix), (x) and (xi).

167. Since the tests in section 82SA are failed (the tests are not cumulative), section 82R operates to deny the deduction for the payments of interest on the Notes.

**Alternative Views**

168. Neither the Note itself nor the Income Security constitutes a 'convertible note' within paragraph (a) of subsection 82L(1); the Note is not to be converted into the shares of any company, or to be redeemed, repaid or satisfied by an allotment or transfer of shares to a person or acquisition of shares by a person, or in paying up an amount unpaid on any shares by a person.

169. Following a Dividend Trigger Event, the Note remains outstanding even though the interest is directed to be paid to the parent rather than the Holder of the relevant beneficial interest in the Note.

***Response***

170. Our views are as expressed above; the Note is a 'convertible note' as defined in paragraph (b) of subsection 82L(1). The Trust Deed discloses that the 'Moneys Owing' upon a Dividend Trigger Event which include 'outstanding principal' as well as accrued interest, become payable to the parent, or at the parent's direction. The subscription price for the Note interest in that case could be seen as the *quid pro quo* for the right to acquire the share.

**If the convertible note provisions do not apply to deny the interest deduction, does Part IVA ITAA 1936 have application to deny the interest deduction?**

171. Part IVA operates where (i) there is a 'scheme' as defined in section 177A; (ii) there is a 'tax benefit' in relation to the scheme which is identified in paragraph (b) of subsection 177C(1) as a deduction allowable to the taxpayer (which would not have been, or might reasonably be expected not to have been, allowed in the relevant year of income if the scheme had not been entered into or carried out); (iii) having regard to the eight matters identified in paragraph (b) of section 177D, it would be concluded that there was the necessary dominant purpose of enabling the taxpayer to obtain the tax benefit; and (iv) the Commissioner makes a determination that the whole or part of the amount of the tax benefit is to be included in the assessable income of the taxpayer (paragraph 177F(1)(a)). The Commissioner then 'shall take such action as he considers necessary to give effect to that determination' (subsection 177F(1)).

### *Identification of the scheme*

*The Payments on the Notes*

172. Where a taxpayer issues a stapled security as described in the Ruling, the scheme may vary from case to case, but the scheme would always include:

- the stapling of an interest in the Note to a preference share;
- the Notes being perpetual;
- the distributions on the interest in the Note being referable to an interest rate but having equity characteristics.

173. The scheme may also include the following features:

- the capital raised represents Tier 1 capital as provided for in the current APRA guidelines on capital adequacy;
- the preference shares issued and stapled to the interests in the Notes are convertible to ordinary shares.

### *The tax benefit test*

174. The Commissioner will identify the tax benefit for the purposes of paragraph 177D(1)(b) as an interest deduction allowable to the taxpayer under section 8-1 in respect of interest payable on the Notes, which would not have been, or might reasonably be expected not to have been, allowed if the scheme had not been entered into or carried out.

175. If the stapling device was considered to be effective in the circumstances to avoid the operation of the convertible note provisions, a deduction is allowable under section 8-1, which would otherwise not be allowable, or might reasonably be expected not to have been allowable pursuant to section 82R.

176. The 'reasonable expectation' test in paragraph 177D(1)(b) requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable: the High Court in *Peabody v FC of T* 94 ATC 4663 at 4671; (1994) 28 ATR 344 at 353.

177. It is reasonable to predict that the taxpayer would have either sought to raise capital under a conventional convertible note, or by the issue of straight (unstapled) converting preference shares or non-cumulative irredeemable preference shares. The latter prediction is considered to be more likely than the issue of conventional convertible

notes. Such preference shares would constitute Tier 1 capital of the parent company, on the same basis as the stapled securities, but the payments of dividends on those shares would not be tax deductible under section 8-1.

### *Dominant purpose*

178. The purpose to which section 177D has regard may be either the sole purpose or, the dominant purpose.

179. The majority of the High Court in *Spotless Services Ltd & Anor v FC of T* 96 ATC 5201 at 5206; (1996) 34 ATR 183 at 188 observed that:

> 'Much turns upon the identification, among various purposes, of that which is "dominant". In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose. In the present case, if the taxpayers took steps which maximised their after-tax return and they did so in a manner indicating the presence of the "dominant purpose" to obtain a "tax benefit", then the criteria which were to be met before the Commissioner might make determinations under s 177F were satisfied.'

180. In this case, the taxpayer has, pursuant to the scheme, taken steps to reduce its assessable income and has done so in a manner indicating the presence of a dominant purpose to obtain a tax benefit.

181. Some or all of the following factors are present in a case to which Part IVA might apply:

- the structure of the securities is designed to produce a tax benefit, by substituting what would otherwise be non-deductible dividends on preference shares (or ordinary shares upon conversion of the preference shares) by deductible 'interest' payments;
- the stapled securities are marketed to issuers in a manner that emphasises the associated tax benefits of 'cost effective capital';
- if the tax benefit is not available, the instrument provides for redemption or otherwise ensures that the investor has only an equity interest in the taxpayer for the purpose of recovering their capital; and
- an absence of commercial reasons for stapling the Note to the preference share.

182. Having regard to the eight factors in paragraph (b) of section 177D:

(i) *the manner of implementing the scheme is artificial;* the issue of the preference shares alone would constitute core equity, and would raise capital for the group. The corresponding payments (of 'interest' instead of dividends, redemption of the Note triggering redemption of the preference shares for no consideration) illustrate that the stapled security is an attempt to achieve a deduction for what would otherwise be the payment of frankable dividends on converting preference shares.

(ii) *the form of the Note instrument is debt, but the substance is equity;* for example, factors pointing to the substance of the instrument being equity include the lack of term, payments are contingent on profits, events of default leave the investor with their preference share investment alone which is convertible at the option of the issuer to ordinary equity. In other words, it is permanent capital to the taxpayer group. In form, the payments of 'interest' are said to be deductible to the Issuer, but on consolidation are treated as dividends.

(iii) *the time at which the scheme was carried out and the length of the period during which the scheme was carried out;* the scheme was carried out at a time when APRA permits under its guidelines instruments in the form of stapled securities to constitute Tier 1 capital. The length of the period during which the scheme was carried out indicates that the instrument is in substance equity, which would ordinary fail the provisions of the convertible notes (see subparagraph 82SA(1)(d)(iv)).

(iv) *the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;* if the scheme is effective to avoid the breadth of the convertible note definition, the scheme would achieve the result that the taxpayer issues Tier 1 capital in return for deductible payments pursuant to section 8-1 of the Act (on the assumption that the payments are not capital).

(v) *any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;* the taxpayer lowers its overall group cost of capital.

(vi) *any change in the financial position of any person who has, or has had, any connection with the taxpayer;* the subsidiary lowers its cost of capital.

(vii) *any other consequence for the relevant taxpayer, or for any person referred to in sub-paragraph (vi), of the scheme having been entered into or carried out;* the group has raised cost effective Tier 1 capital.

(viii) *the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in sub-paragraph (vi);* the Issuer of the Notes is a wholly-owned subsidiary of the taxpayer and the Trustee is liable to come under the control of the parent, upon the occurrence of a Payment Direction Event.

183. Each case must be considered on its own merits. However, having regard to the eight factors listed above contained in paragraph 177D(b), it is open to a reasonable person objectively to conclude that a person or persons, who has entered into or carried out a scheme with some or all of the characteristics outlined in paragraphs 172 and 173 above, did so for the dominant purpose of enabling the relevant taxpayer to obtain a tax benefit. In such a case, it would be appropriate for the Commissioner to exercise his discretion under section 177F to determine that the whole or part of the deduction otherwise allowable shall not be allowable to the taxpayer.

***Is the payment under the Procurement Agreement deductible?***

184. A payment is made to the Underwriters under the Procurement Agreement by the parent company in consideration for which the Underwriters gives a signed Payment Direction to the parent directing the Issuer and the Trustee to pay any amounts payable in respect of the Notes to the parent company or as it directs upon the happening of a Payment Direction Event or Dividend Trigger Event. The payment reimburses the Underwriter for its loss on transferring the Income Securities to the Holders. The loss arises because the Underwriter has paid consideration for both the interest in the Note and the preference share for a total amount of the issue price of the preference share and the face value of the Note but is required to transfer the Income Security to the Holder for half that consideration. Upon subscription for the interest in the Note and the preference share, the Underwriter has immediately signed an agreement to potentially divest itself of its right to receive payments in respect of the securities.

*Section 8-1 ITAA 1997*

185. We consider that the payment made to the Underwriters by the parent company under the Procurement Agreement is not an outgoing incurred in gaining or producing assessable income or necessarily

incurred in carrying on a business for the purpose of gaining or producing assessable income.

186. It is a reimbursement payment to compensate the Underwriters for their loss. In addition, in one arrangement, the payment is made ostensibly to acquire a right to require the Trustee and the Issuer of the Notes to pay the 'principal' and 'interest' on the Notes to the parent company, which is a right that the parent company always retained. A 'Payment Direction Event' is defined in that arrangement to include the giving of notice by the parent company to the Trustee at any time that it requires all payments of 'interest' and 'principal' on the Notes to be paid to it as they become due, and not to investors.

*Section 25-25 ITAA 1997*

187. Subsection 25-25(1) allows a deduction for expenditure incurred by the taxpayer for borrowing money to the extent that the borrowed money is used for the purpose of producing assessable income. 'Borrowing' is defined in section 995-1 ITAA 1997 to mean 'any form of borrowing, whether secured or unsecured, and includes the raising of funds by the issue of a bond, debenture, discounted security or other document evidencing indebtedness'.

188. As explained above, it is not considered that the taxpayer is raising capital by way of a 'borrowing'. The Notes are issued to the Trustee to be held on behalf of the Underwriters as Initial Holders on terms that *upon issue of the Note*, the 'Holder's Interest' (being the beneficial interest in the Note) held by the Initial Holder is stapled to a Preference Share issued to the Initial Holder. The stapled security comprising the Note interest is not evidence of indebtedness, but is a subscription for permanent capital.

*Part IVA*

189. It would appear that the procurement payment and the benefit that it secures of the Payment Direction ensures that the parent retains control over the arrangement, and allows it to perpetuate an arrangement which does not resemble debt. If the view is taken that consideration under the contract is properly to be taken to be allocated towards the subscription price of the preference share issued by the parent if the terms of those shares import the collateral transfer of the Notes to the parent, the device of the Procurement payment is entirely otiose (see paragraph 102 above).

190. The Procurement Agreement fee is not allowable under section 8-1 ITAA 1997. If it is, we consider Part IVA will apply to the Procurement Agreement fee in the same way as we consider it applies to the payments on the Notes.

**Obligation of the Issuer to pay or withhold tax on behalf of non-residents**

191. For the reasons set out in paragraphs 78 to 103 above, the periodic payments on the notes are not considered to be payments of interest; nor do they come within the extended definition of 'interest' in subsection 128A(1AB) ITAA 1936. It follows that the Issuers are not required to withhold tax under Subdivision A of Division 11A of the ITAA 1936.

192. Where, however, the non-resident Holder has an Australian tax liability in respect of the payments, the Issuer may be required under section 255 ITAA 1936 to retain out of those payments sufficient funds to pay the tax which is or will become due by the non-resident.

# Detailed contents list

193. Below is a detailed contents list for this draft Taxation Ruling:

## Your comments

194. We invite you to comment on this draft Taxation Ruling. We are allowing 6 weeks for comments before we finalise the Ruling. If

you want your comments to be considered, please provide them to us within this period.

**Comments by Date:** **6 April 2001**
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**Commissioner of Taxation**
21 February 2001

*Previous draft:*
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Related Rulings/Determinations:
IT 2334; IT 2427; IT 2657;
TR 95/25; TR 2000/17;

*Subject references:*
- capital
- capital adequacy
- contingent payments
- convertible note
- converting preference share
- cumulative
- debt
- debtor-creditor relationship
- deductions
- dividends
- income securities
- interest expenses
- loan
- non-cumulative
- periodic payments
- perpetual notes
- preference shares
- procurement payment
- stapled securities
- Tier 1

*Legislative references:*
- ITAA 1936 Pt III Div 3A
- ITAA 1936 51(1)
- ITAA 1936 82L(1)
- ITAA 1936 82(R)
- ITAA 1936 82R(3)
- ITAA 1936 82SA
- ITAA 1936 128(1AB)
- ITAA 1936 Part IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1936 177F
- ITAA 1936 255
- ITAA 1997 8-1
- ITAA 1997 8-1(2)
- ITAA 1997 8-1(2)(a)
- ITAA 1997 25-25

*Case references:*
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[1902] 1 Ch 353
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- Charles E. Curry 43 TC 667, 686 16 (1965)
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- Dunn Trust Ltd v. Feetham [1936] 1 KB 22, CA
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- FC of T v. The Midland Railway Co. of Western Australia Ltd (1951) 85 CLR 306
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- Helvering v. Richmond F. & P.R.R, 90 F. 2d 971 (4th Cir. 1937)
- Jewel Tea Co v. United States 90 F. 2d 451, 453 (2d Cir. 1937)
- John Fairfax & Sons Pty Ltd v. FC of T (1959) 101 CLR 30
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- NM Superannuation Pty Ltd v. Young (1993) 113 ALR 39
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- Re Farm Security Act 1944 [1947] SCR 394
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- Smithkline Beecham Laboratories (Australia) Ltd v. F C of T 93 ATC 4629; (1993) 26 ATR 260
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- Sun Newspapers Ltd and Associated Newspapers Ltd v. FC of T (1938) 61 CLR 337
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