



Class Ruling

Income tax: Bendigo and Adelaide Bank Limited – allotment of convertible preference shares 3

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📌 This publication provides you with the following level of protection:

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

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

What this Ruling is about

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

Relevant provision(s)

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

- section 6BA of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subparagraph 44(1)(a)(i) of the ITAA 1936
- section 45 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 177EA of the ITAA 1936
- subsection 6-5(1) of the *Income Tax Assessment Act 1997* (ITAA 1997)
- Division 67 of the ITAA 1997

- section 104-25 of the ITAA 1997
- section 104-155 of the ITAA 1997
- section 109-10 of the ITAA 1997
- subsection 110-25(2) of the ITAA 1997
- subsection 110-55(2) of the ITAA 1997
- Subdivision 130-A of the ITAA 1997
- section 204-30 of the ITAA 1997, and
- Division 207 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies are investors who acquired Convertible Preference Shares 3 (CPS3) in Bendigo and Adelaide Bank Limited (BEN) and who:

- were residents of Australia (within the meaning of subsection 6(1) of the ITAA 1936)
- held their CPS3 on capital account, and
- were not subject to the taxation of financial arrangement rules in Division 230 on financial arrangements under the scheme.

(Note: Division 230 will generally not apply to the financial arrangements of individuals, unless they have made an election for those rules to apply to them.)

4. The class of entities described in the above paragraph is referred to in this Ruling as Holders.

5. The class of entities to which this Ruling applies does not extend to Holders who did not acquire their CPS3 by initial subscription under BEN Convertible Preference Shares 3 Prospectus and BPS Reinvestment Offer Information dated 27 April 2015 and subsequently replaced on 5 May 2015 (Prospectus).

Qualifications

6. This Ruling does not deal with how the taxation law applies to BEN in relation to the issue of the CPS3.

7. This Ruling does not consider the tax implications of the Exchange of CPS3 by way of Redemption or Resale.

8. This Ruling does not consider the tax implications of the Exchange of the BEN Preference Shares (BPS) to reinvest in the CPS3.

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

10. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

11. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 59 of this Ruling.

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

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

Date of effect

13. This Ruling applies from 1 July 2014 to 30 June 2024. The Ruling continues to apply after 30 June 2024 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

14. The following description of the scheme is based on information provided by the applicant on behalf of BEN. The following documents, or relevant parts of them, form part of and are to be read with the description:

- application for Class Ruling dated 6 March 2015
- the Prospectus
- the CPS3 Terms dated 5 May 2015 (Terms), and
- further correspondence and information provided by the applicant.

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

15. In this Ruling, unless otherwise defined, capitalised terms take the meaning as in the Prospectus and Terms.

16. BEN is an Australian resident company for income tax purposes and is the head company of an income tax consolidated group (BEN consolidated group). BEN is listed on the Australian Securities Exchange (ASX).

17. BEN is an authorised deposit-taking institution for the purposes of the *Banking Act 1959* and is subject to regulatory compliance requirements as administered by the Australian Prudential Regulatory Authority (APRA).

18. On 27 April 2015 BEN announced to the ASX its intention to raise approximately \$200 million through the offer of CPS3.

19. The funds raised from the issue of the CPS3 will be used for BEN's general business purposes and as part of BEN's ongoing capital management strategy in meeting its regulatory capital requirements under the guidelines prescribed by APRA.

20. APRA has confirmed that the CPS3 will be treated as Additional Tier 1 Capital under the Prudential Standard APS 111.

21. The Issue Date for the CPS3 was 15 June 2015. The CPS3 is listed on the ASX under the ASX code 'BENPF'.

22. Holders of BPS, who held their BPS on the Issue Date, were able to apply under the Reinvestment Offer to have their BPS holdings redeemed and the proceeds re-invested in the CPS3. There was a guaranteed allocation for Eligible BPS Holders who participated in the Reinvestment Offer.

23. The classes of Applicants who were able to apply for the CPS3, and the corresponding process for lodging applications, as described in the Prospectus, were:

- Securityholder Applicant – a holder of Ordinary Shares, CPS, CPS2 or Capital Notes in BEN with a registered address in Australia, applying through the Securityholder Offer
- Eligible BPS Holder Applicant – a holder of BPS with a registered address in Australia, and is not in the United States or acting as a nominee for a person in the United States, applying through the Reinvestment Offer
- General Applicant – a member of the general public who is an Australian resident applying through the General Offer
- Broker Firm Applicant – a retail client of a Syndicate Broker, including Eligible BPS Holders, who is an Australian resident applying through the Broker Firm Offer, and
- Institutional Investor – a sophisticated or professional investor who is not in the United States and is invited by the Joint Lead Managers to participate in the offer and who is applying through the Institutional Offer.

24. No action was taken to register or qualify the CPS3 to permit a public offering of the CPS3 outside Australia. However, the CPS3 may have been offered in a jurisdiction outside Australia under the Institutional Offer where such an offer was made in accordance with the laws of that jurisdiction.

Main features of the CPS3

25. The CPS3 are fully-paid, unsecured, non-cumulative, transferable, redeemable, convertible preference shares in the capital of BEN.

26. The issue price for each CPS3 is \$100 and will be fully paid up to its \$100 face value on issue.

27. A Holder will not have voting rights under the CPS3 except in the limited circumstances described in the Terms.

Dividend payment conditions

28. Each Dividend is subject to:

- the Directors, at their absolute discretion, resolving to pay the Dividend on the relevant Dividend Payment Date
- the payment of the Dividend not resulting in a breach of BEN's Prudential Capital Requirements (on a Level 1 basis) or of the BEN Group's Prudential Capital Requirements (on a Level 2 basis) under the Prudential Standards as they apply to BEN or the BEN Group (as the case may be) at the time of the payment
- paying the Dividend not resulting in BEN becoming, or likely to become, insolvent for the purposes of the *Corporations Act 2001*, and
- APRA not otherwise objecting to the payment of the Dividend.

29. A Dividend is only payable to those persons registered as a holder of the CPS3 on the Record Date for that Dividend.

30. The Dividends are non-cumulative and Holders will not have any recourse in the event of non-payment. Non-payment of all, or part, of a Dividend does not constitute an event of default by BEN, and the Holders have no claim in respect of non-payment.

31. No interest accrues on any unpaid Dividends and the Holders have no claim or entitlement in respect of interest on any unpaid Dividends.

Dividend calculation

32. Subject to conditions in paragraph 28, a Holder is entitled to receive, on the relevant Dividend Payment Date, a Dividend payable only in cash and calculated according to the following formula:

$$\text{Dividend} = \frac{\text{Issue Price} \times \text{Dividend Rate} \times \text{N}}{365}$$

where:

Dividend Rate (expressed as a percentage per annum) is calculated according to the following formula:

$$\text{Dividend Rate} = (\text{Bank Bill Rate} + \text{Margin}) \times (1 - \text{Tax Rate})$$

where:

Bank Bill Rate (expressed as a percentage per annum) means, for a Dividend Period, the average mid-rate for bills of a term of 180 days which average mid-rate is displayed on Thomson Reuters page BBSW (or any page which replaces that page) on the first Business Day of the Dividend Period or, if there is a manifest error in the calculation of that average mid-rate or that average mid-rate is not displayed by 10:16am (Melbourne time) on that date, the rate specified in good faith by BEN at or around 10:30am (Melbourne time) on that date having regard, to the extent possible, to:

- (a) the rates otherwise bid and offered for bills of a term of 180 days or for funds of that tenor displayed on Thomson Reuters page BBSW (or any page which replaces that page) at or around that time on that date; or
- (b) if bid and offer rates for bills of a term of 180 days are not otherwise available, the rates otherwise bid and offered for funds of that tenor at or around that time on that date;

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

Tax Rate (expressed as a decimal) means the Australian corporate tax rate applicable to the franking account of BEN at the relevant Dividend Payment Date, and

N means in respect of:

- (a) the first Dividend Payment Date, the number of days from (and including) the Issue Date until (but not including) the first Dividend Payment Date, and
- (b) each subsequent Dividend Payment Date, the number of days from (and including) the preceding Dividend Payment Date until (but not including) the relevant Dividend Payment Date.

33. Dividends are expected to be fully franked. If a Dividend is not franked to 100%, the Dividend will be grossed-up as follows:

$$\text{Dividend} = \frac{D}{1 - (\text{Tax Rate} \times (1 - F))}$$

where:

D means the Dividend calculated under paragraph 32;

Tax Rate (expressed as a decimal) means the Australian corporate tax rate applicable to the franking account of BEN at the relevant Dividend Payment Date; and

F means the percentage (expressed as a decimal) to which the Dividend is franked under Part 3-6 of the Tax Act or any provisions that revise or replace that Part.

Conversion mechanics

34. Upon Conversion, each CPS3 that is being Converted will Convert into one Ordinary Share in BEN. The Conversion is undertaken by a variation of rights attaching to the CPS3. There is no amount credited to the Holders or paid out of BEN's profits.

35. For each CPS3 Converted, each Holder will also be allotted, for no consideration, an additional number of Ordinary Shares in BEN equal to one less than the Conversion Number, but not more than the Maximum Conversion Number, each of which is calculated according to the applicable formula in clause 8.1(b) of the Terms.

Interposition of Approved NOHC

36. An Approved Non-Operating Holding Company (NOHC) event results in the Approved NOHC becoming the ultimate holding company of BEN, with the agreement that it will issue ordinary shares in itself under all circumstances that BEN would otherwise have been obliged to deliver under a Conversion.

37. If an Approved NOHC event occurs, BEN may give notice to the Holders specifying amendments to the Terms to effect the substitution of the NOHC as the issuer of the ordinary shares to the Holders on Conversion.

Redemption mechanics

38. BEN may elect to Redeem the CPS3 in accordance with the Terms and subject to APRA's prior written approval.

39. Redeem means either redeem, buy-back (other than an on-market buy-back within the meaning of the *Corporations Act 2001*) or reduce capital, or any combination of such activities.

40. Where the CPS3 are redeemed, BEN will pay the Issue Price plus any amount that the Directors may resolve to pay that is an amount equal to a Dividend for the Dividend Period ending on (but not including) the Exchange Date (Redemption Price).

41. On the Exchange Date, the Holders will only have a right to the Redemption Price, and upon payment of the Redemption Price, all other rights conferred or restrictions imposed by the CPS3, will no longer have effect.

Resale mechanics

42. BEN may elect to Resell the CPS3 in accordance with the Terms and subject to APRA's prior written approval.

43. If BEN elects to Resell the CPS3 BEN must appoint one or more third parties (Nominated Purchaser) to facilitate the resale.

44. On the Exchange Date for each CPS3 held, the Holder will receive the Resale Price and all rights, title and interest in the CPS3 (excluding the right to any Dividend payable on that date) will be transferred to the Nominated Purchaser.

Conversion, Redemption and Resale events

45. The CPS3 will Convert, Redeem or Resell in the circumstances referred to below.

Change of Control Event

46. If a Change of Control Event occurs, BEN must Convert all the CPS3 on the Change of Control Conversion Date.

47. A Change Of Control Event occurs when both an Acquisition Event and one of the following has occurred:

- if the Acquisition Event is a result of a takeover bid, all regulatory approvals necessary for the acquisition to occur have been obtained, or
- if the Acquisition Event is a result of a scheme of arrangement, all conditions to the implementation of the scheme, including any necessary regulatory or shareholder approvals (including relevant court approval) have been satisfied or waived.

Automatic Conversion

48. Automatic Conversion means the Conversion of CPS3 to Ordinary Shares in accordance with clause 5.3 of the Terms on either:

- the Capital Trigger Conversion Date on the occurrence of a Capital Trigger Event, or
- the Non-Viability Conversion Date on the occurrence of a Non-Viability Trigger Event.

49. A Capital Trigger Event occurs when BEN determines, or APRA issues BEN a notice in writing that it believes, that either or both of BEN's Level 1 Common Equity Tier 1 Capital Ratio or Level 2 Common Equity Tier 1 Capital Ratio is equal to or less than 5.125%.

50. If a Capital Trigger Event occurs, BEN must either Convert or write-off all or some of the CPS3, to a level that results in satisfying the aforementioned ratio.

51. A Non-Viability Trigger Event occurs when APRA provides a written determination to BEN that a conversion to Ordinary Shares or write-off of its Additional Tier 1 Capital (which includes the CPS3) is necessary because either APRA considers that BEN would otherwise become non-viable or, without public sector injection of capital or equivalent support, APRA considers BEN would become non-viable.

52. If a Non-Viability Trigger Event occurs, where APRA deems a public sector injection of funds to be necessary, BEN must either Convert or write off all of the CPS3. In any other case on the occurrence of a Non-Viability Trigger Event, BEN must either Convert or write-off all or some of the CPS3 to a level that satisfies APRA.

Mandatory Conversion

53. Unless Converted earlier, BEN will mandatorily convert all CPS3 on the Mandatory Conversion Date.

54. Subject to all of the Mandatory Conversion Conditions being satisfied, the Mandatory Conversion Date will be the date that is the earlier of 15 June 2023, or the first dividend payment date after 15 June 2023, on which the Mandatory Conversion Conditions are satisfied.

55. The Mandatory Conversion Conditions for each Relevant Date (being the relevant Mandatory Conversion Date) are:

- the daily volume weighted average sale prices (VWAP) of BEN ordinary shares on the 25th Business Day on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Mandatory Conversion Date is greater than 55.00% of the VWAP on the date of issue

- the VWAP during the period of 20 Business Days on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Mandatory Conversion Date is greater than 50.505% of the VWAP on the date of issue, and
- no Delisting Event applies in respect of the Relevant Date.

Optional Exchange

56. Subject to APRA's prior written approval, BEN may elect to Exchange at its discretion:

- all or some CPS3 on the Exchange Date following the occurrence of a Tax Event or a Regulatory Event
- all (but not some) CPS3 on the Exchange Date following the occurrence of an Acquisition Event, or
- all or some CPS3 on the Optional Exchange Date (being 15 June 2021).

57. If BEN elects to Exchange the CPS3, it must elect which of the following (or combination of the following) methods of Exchange will apply to the CPS3:

- Convert the CPS3 into Ordinary Shares in BEN in accordance with clause 8 of the Terms
- Redeem the CPS3 in accordance with clause 9 of the Terms, or
- Resell the CPS3 in accordance with clause 10 of the Terms.

58. A Holder does not have the right to request Exchange at any time or to determine the method of Exchange.

Other matters

59. This Ruling is made on the basis that:

- (a) all parties to the transaction are dealing with each other at arm's length
- (b) the CPS3 are equity interests in BEN pursuant to Division 974
- (c) the accounting classification of the CPS3 is a debt
- (d) the majority of the holders of CPS3 are expected to be residents of Australia for tax purposes, although some may be non-residents
- (e) the additional Ordinary Shares issued in the event of Conversion of the CPS3 will be equity interests in BEN pursuant to Division 974

- (f) Dividends will be frankable distributions pursuant to section 202-40
- (g) BEN will frank the Dividends paid on CPS3 in accordance with Division 203 and will adopt the same franking percentage as the benchmark for the period in which the dividend payment is made
- (h) BEN expects to continue with its policy of franking any frankable distributions (to the extent that franking credits are available in its franking account)
- (i) BEN expects to have sufficient available profits from which it will pay Dividends, and its net assets will exceed its ordinary share capital immediately before the payment of any Dividends
- (j) no part of the Dividends will be sourced, directly or indirectly, from BEN's share capital account or its non-share capital account or from unrealised or untaxed profits
- (k) the share capital of BEN will not become tainted within the meaning of Subdivision 197-A by the issue of the CPS3 or the allotment of additional ordinary shares on Conversion of the CPS3
- (l) for the purposes of determining whether a Holder is a 'qualified person' under Division 1A of former Part IIIAA of the ITAA 1936 in relation to the Distributions, a Holder has taken no positions (apart from the holding of the CPS3) in relation to their CPS3 and will not be under an obligation or be likely to make a related payment in relation to the Dividends
- (m) the Holders, or their associates, will not make any related payments (within the meaning of former section 160APHN of the ITAA 1936) in relation to the Dividends on the CPS3
- (n) BEN will not differentially frank Dividends to different Holders in respect of the CPS3 according to the tax status of Holders or on any other basis
- (o) the Holders in receipt of Dividends will have held their CPS3 for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the CPS3), within the period beginning on the day after the day on which the Holder acquired the CPS3 and ending on the 90th day after the day on which the CPS3 become ex-dividend

- (p) the dividend payout ratios and the franking credits arising in relation to the payment of dividends on the ordinary shares or other preference shares of BEN do not materially change as a result of the issue of the CPS3, nor on any subsequent Conversion, Redemption or Resale of the CPS3
- (q) on the date of Conversion of the CPS3 into Ordinary Shares, the rights and obligations attached to those Ordinary Shares are the same as those contained in the Constitution of BEN, and
- (r) the accounts of BEN and its subsidiaries are prepared in accordance with the applicable accounting standards.

Ruling

Acquisition time of the CPS3

60. Under section 109-10, the Holders acquired the CPS3 on the Issue Date, being the date the CPS3 was issued to them.

CPS3 cost base and reduced cost base

61. Under subsections 110-25(2) and 110-55(2) the first element of the cost base and reduced cost base of each CPS3 is \$100.

Inclusion of Dividends and franking credits in assessable income

62. The Holders must include in their assessable income all Dividends received under subparagraph 44(1)(a)(i) of the ITAA 1936, and an amount equal to the franking credit received on those Dividends under Division 207, unless the Holder is an entity whose ordinary or statutory income is exempt income.

Entitlement to a tax offset

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

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

Exempt income or non-assessable non-exempt income

65. If the Dividend (or a part of it) is either exempt income or non-assessable non-exempt income in the hands of the relevant Holder, then the amount of any franking credit on the Dividend is not included in the assessable income of the Holder and the Holder is not entitled to a tax offset under Division 207 (Subdivision 207-D).

Imputation benefits – streaming

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

Section 177EA

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

Gross-up and tax offset rules

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

Conversion of each CPS3 and allotment of additional Ordinary Shares – Capital Gains Tax (CGT) implications

69. The Conversion of each CPS3 into Ordinary Shares and the allotment of additional Ordinary Shares will not result in any CGT event occurring.

70. Specifically, CGT event C2 in section 104-25 will not occur upon the Conversion of the CPS3 into Ordinary Shares via a variation of rights and allotment of additional Ordinary Shares. Furthermore, CGT Event H2 in section 104-155 will not happen upon the Conversion of each CPS3 via a variation of rights and allotment of additional Ordinary Shares as a cost base adjustment will be made to the Converted CPS3 because of the allotment of the additional Ordinary Shares.

Cost base of the additional Ordinary Shares

71. Section 6BA of the ITAA 1936 and Subdivision 130-A will apply to apportion the first element of the cost base and reduced cost base of each CPS3 over the Converted CPS3 and any additional Ordinary Shares allotted by BEN.

Acquisition time of the additional Ordinary Shares

72. Under subsection 130-20(3) the additional Ordinary Shares will be taken to be acquired at the time the CPS3 are originally acquired by the holders, being 15 June 2015.

Allotment of additional Ordinary Shares – dividend

73. The allotment of any additional Ordinary Shares on Conversion of CPS3 will not be assessable as dividend income in the hands of the Holders.

The value of additional Ordinary Shares – ordinary income

74. The value of any additional Ordinary Shares issued on Conversion of CPS3 will not be assessable as ordinary income in the hands of the Holders under subsection 6-5(1).

Conversion of each CPS3 and allotment of Ordinary Shares in an Approved NOHC – CGT implications

75. Where an Approved NOHC becomes the ultimate holding company of BEN, the Conversion of each CPS3 and the allotment of NOHC Ordinary Shares to Holders will result in CGT event C2 happening (section 104-25).

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

77. The amendment to the Terms to effect the substitution of an Approved NOHC as the issuer of Ordinary Shares to Holders on Conversion of the CPS3 will result in CGT event H2 happening (section 104-155).

78. However, no Holder will make a capital gain or capital loss as a result of CGT event H2 happening as there will be no capital proceeds because of the amendments to the Terms.

Cost base of the Approved NOHC Ordinary Shares

79. Under item 2 of the table in subsection 130-60(1), the first element of the cost base and the reduced cost base of each Approved NOHC Ordinary Share allocated to the Holders will be their cost base in the CPS3 at the time of Conversion divided by the number of Approved NOHC Ordinary Shares they receive for each CPS3.

Acquisition time of Approved NOHC Ordinary Shares

80. Under subsection 130-60(2), the Approved NOHC Ordinary Shares will be taken to be acquired at the time of the Conversion of the CPS3.

Section 45

81. Section 45 of the ITAA 1936 will not apply to treat the additional Ordinary Shares acquired on Conversion of the CPS3 as an unfranked dividend paid by BEN.

Section 45A

82. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that the additional Ordinary Shares acquired on Conversion of the CPS3 is an unfranked dividend in the hands of the Holders.

Section 45B

83. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that the additional Ordinary Shares acquired on Conversion of the CPS3 is an unfranked dividend in the hands of the Holders.

Commissioner of Taxation24 June 2015

Appendix 1 – Explanation

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

Acquisition time of the CPS3

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

85. A Holder acquired their CPS3 on the Issue Date, being the date the CPS3 was issued. Accordingly, for the purposes of item 2 in the table contained in section 109-10, the CPS3 is acquired on 15 June 2015.

CPS3 cost base and reduced cost base

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

87. The issue price of each CPS3 is \$100. Accordingly, when the CPS3 issued, the first element of the cost base and reduced cost base of each CPS3 is \$100.

Inclusion of Dividends and franking credits in assessable income

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

89. A 'dividend' is defined in subsection 6(1) of the ITAA 1936 to include any distribution made by a company to any of its shareholders, whether by money or other property, but does not include an amount that has been debited against an amount standing to the credit of the company's share capital account.

90. Dividends paid in respect of the CPS3 will be paid out of BEN's profits (but not from unrealised or untaxed profits) and will not be sourced from its share capital account or non-share capital account. Accordingly, Dividends paid in respect of each CPS3 are dividends under subsection 6(1) of the ITAA 1936 and must be included in a Holder's assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

91. Dividends paid in respect of the CPS3 are expected to be fully franked.

92. Under the Australian imputation system, where a franked distribution is paid by an Australian resident company to a shareholder, the assessable income of the shareholder must also include the franking credit attached to the dividend under Division 207. The inclusion of both the dividend and the associated franking credit in a shareholder's assessable income is termed 'grossing-up' the dividend receipt.

93. Accordingly, the Holder must include in their assessable income the amount of the franking credit.

Entitlement to a tax offset

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

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

96. Accordingly, the Holders will be subject to the refundable tax offset rules unless they are listed as specifically excluded entities under section 67-25.

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

Exempt income or non-assessable non-exempt income

98. Subdivision 207-D creates an adjustment to cancel the effect of the gross-up and tax offset rules if a dividend (or a part of it) is either exempt income or non-assessable non-exempt income in the hands of the relevant Holder. The amount of any franking credit is not included in the assessable income of the Holder and the Holder is not entitled to a tax offset under Division 207.

Imputation benefits – streaming

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

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

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

101. 'Streaming' is not defined for the purposes of Subdivision 204-D; however, paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002 provides that it is 'selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits'.

102. BEN has indicated that all the Holders will receive fully franked dividends regardless of their tax attributes or their individual tax position. BEN's dividend payment policy, and its franking credit policy, in relation to its Ordinary Shares or other preference shares, will not be materially affected by the issue of the CPS3.

103. The additional Ordinary Shares allotted on Conversion of CPS3 will not attract the application of section 204-30. This is because the issue of the additional Ordinary Shares will not constitute a distribution and the allotment of additional Ordinary Shares will not materially affect BEN's fully franked dividend policy.

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

Section 177EA

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

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

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

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity, and
- (b) either:
 - a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests, or
 - a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be, and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit, and
- (d) except for this section, the person (the relevant taxpayer) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution, and
- (e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose, but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

107. The Commissioner considers that the conditions in paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied.

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

109. The relevant circumstances listed in subsection 177EA(17) of the ITAA 1936 encompass a range of circumstances which taken individually, or collectively, could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may or may not be present at any one time in any one scheme.

110. On the basis of the information provided, the qualifications set out in this Ruling and consideration of all the relevant circumstances of the scheme, it could not be concluded that the purpose of enabling Holders to obtain imputation benefits is more than incidental to BEN's purpose of raising Additional Tier 1 Capital to meet its capital adequacy requirements.

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

Gross-up and tax offset rules

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

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

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

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

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

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

117. The Holders will be qualified persons, provided that:

- the Holders will have held their CPS3 at risk for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the shares or interest) in the period beginning on the day after the day on which the Holders acquired CPS3 and ending on the 90th day after the day on which CPS3 become ex-dividend (former subsections 160APHO(2) and 160APHO(3) and former sections 160APHM and 160APHJ of the ITAA 1936); and
- neither the Holders, nor associates of the Holders, have made, are under an obligation to make, or are likely to make a related payment in relation to the Dividends on CPS3 (former paragraph 160APHO(1)(a) and former section 160APHN of the ITAA 1936).

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

119. The Commissioner has confirmed that he will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) to deny the imputation benefits attached to Dividends paid by BEN to the Holders.

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

121. The description of the scheme provides no indication that the offering of the CPS3 and the associated payment of franked dividends to the Holders in any way constitutes a dividend stripping operation.

122. Therefore, section 207-145 will not apply to the Dividends received by the Holders in respect of the CPS3. Accordingly, section 207-145 will not adjust the Holder's assessable income to exclude the amount of the franking credit on the Dividend, nor will it deny the tax offset to which the Holder would otherwise be entitled.

Conversion of each CPS3 and allotment of additional Ordinary Shares – CGT implications

123. Under the Terms, each CPS3 will convert into one Ordinary Share through a variation of the rights attached to each CPS3. The Holders will also receive an allotment of additional Ordinary Shares in BEN in accordance with the Terms.

124. Each CPS3 comprises a bundle of rights; however, those rights are not separate pieces of property capable of being divided out and held separately. Accordingly, the rights attaching to each CPS3 do not constitute individual assets as defined by section 108-5, but rather combine to make up the relevant CGT asset, being the share (Taxation Ruling TR 94/30).

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

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

126. The mere variation of rights attaching to CPS3 and allotment of an additional number of Ordinary Shares for no consideration will not result in the ownership of an intangible CGT asset coming to an end by the share being redeemed or cancelled under paragraph 104-25(1)(a).

127. Further, the Conversion of CPS3 to Ordinary Shares by the variation of the rights attaching to CPS3 will not result in the ownership of an intangible CGT asset coming to an end by the CPS3 being converted under paragraph 104-25(1)(f).

128. The relinquishment by the Holders of some of the rights attaching to the CPS3 is not a CGT event that happens to part of the CGT asset comprised by each CPS3 under section 112-30 (paragraph 40 of TR 94/30).

129. As CGT event C2 will not occur on Conversion of CPS3 into Ordinary Shares, Subdivision 130-C will have no application.

130. Although CGT event C2 does not happen because of the variation of the rights attaching to CPS3, the receipt of money or other consideration in respect of such a variation may attract the operation of CGT event H2 (paragraphs 9 and 46 to 48 of TR 94/30).

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

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

132. The Conversion of CPS3 involving the allotment of additional Ordinary Shares will result in an adjustment to the cost base and reduced cost base of the Converted CPS3 under Subdivision 130-A and section 6BA of the ITAA 1936.

133. Accordingly, CGT event H2 will not happen on the Conversion of CPS3 involving the allotment of additional Ordinary Shares.

134. No other CGT event in Division 104 will occur as a result of the Conversion of the CPS3.

Cost base of the additional Ordinary Shares

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

136. Pursuant to subsection 6BA(3) of the ITAA 1936, as the additional Ordinary Shares will be issued to Holders for no consideration and will not be a dividend or taken to be a dividend, the Issue Price of the CPS3 will be apportioned over the Converted CPS3 and any additional Ordinary Shares allotted.

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

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

139. Under item 1 of the table in subsection 130-20(3), as the additional Ordinary Shares will not be a dividend nor will they be taken to be a dividend, the first element of the cost base and reduced cost base of each CPS3 will be apportioned over both the Converted CPS3 and any additional Ordinary Shares issued to the Holders by BEN.

Acquisition time of the additional Ordinary Shares

140. The Holders will be taken to have acquired the additional Ordinary Shares at the time when the CPS3 are originally acquired by the Holders, being 15 June 2015 (subsection 130-20(3)).

Allotment of additional Ordinary Shares – dividend

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

142. Although the additional Ordinary Shares to be issued on Conversion of the CPS3 will constitute 'property' in the hands of the Holders, the allotment will not be a disposition of property in the ordinary meaning of that expression (*Ord Forrest Pty Ltd v. FC of T* (1973) 130 CLR 124; (1973) 74 ATC 4034; (1973) 4 ATR 230, per Barwick CJ and McTiernan J). As there will be no disposition there cannot be a distribution of property by BEN.

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

144. Furthermore, no amount will be credited to the Holders, nor will an amount be paid out of profits.

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

The value of additional Ordinary Shares – ordinary income

146. The allotment of additional Ordinary Shares will be a bonus issue within the meaning of paragraph 254A(1)(a) of the *Corporations Act 2001*, because it is an issue of shares for which no consideration is payable to BEN. The issue of additional Ordinary Shares will result in a re-expression of the Holder's interest in the share capital of BEN.

147. Accordingly, the value of any additional Ordinary Shares issued on Conversion of the CPS3 will not be assessable as ordinary income under subsection 6-5(1) (*Federal Commissioner of Taxation v. McNeil* (2007) 229 CLR 656; 2007 ATC 4223; (2007) 64 ATR 431).

Conversion of each CPS3 and allotment of Ordinary Shares in an Approved NOHC – CGT implications

148. The Terms provide for the possibility of an Approved NOHC to become the ultimate owner of BEN. If this occurs, BEN may amend the Terms and provide notice to Holders that upon Conversion, shares in the Approved NOHC will be allotted to the Holders instead of BEN Ordinary Shares.

CGT event C2

149. Under section 104-25, CGT event C2 happens if, among other things, the ownership of an intangible asset that is a convertible interest ends by the conversion of the asset into another asset (paragraph 104-25(1)(f)). If an approved NOHC becomes the ultimate owner of BEN, upon conversion, CGT Event C2 will occur as the CPS3 will be transferred to the Approved NOHC and Ordinary Shares in the Approved NOHC will be allotted to Holders.

150. However, Subdivision 130-C applies to the acquisition of shares by the conversion of a convertible interest by disregarding any capital gain or capital loss made as a result of CGT event C2 happening. In order for this Subdivision to apply to the Conversion of the CPS3, the CPS3 must be a convertible interest.

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

152. The term 'an interest that will or may convert into another interest' is defined in section 974-165. It includes the circumstances where a first interest must be, or may be, satisfied by the issue of the second interest (subparagraph 974-165(b)(i)).

153. The term 'connected entity' is defined in subsection 995-1(1) and includes an 'associate' of the entity being tested. 'Associate' is widely defined in subsection 995-1(1) and section 318 of the ITAA 1936.

154. The CPS3 is considered to be an interest that will or may convert into another interest and as the Approved NOHC will be the parent company of BEN at the time of the Conversion, the Approved NOHC will be an associate, and thus a connected entity of BEN.

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

CGT event H2

156. An Approved NOHC becoming the ultimate owner of BEN will not, by itself, result in a CGT event for Holders in respect of their CPS3.

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

158. The amendment to the Terms to effect the substitution of an Approved NOHC as the issuer of Ordinary Shares on Conversion results in CGT event H2 happening for Holders. The amendment to the Terms is an act, transaction or event in relation to the CPS3 that does not result in an adjustment being made to the cost base or reduced cost base of the CPS3.

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

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

161. Holders will not make a capital gain or capital loss from the happening of CGT event H2 as there will be no capital proceeds because of the amendments to the Terms and no incidental costs will be incurred by the Holders that relate to these amendments. No other CGT event will happen because of the amendments to the Terms.

Cost base of the Approved NOHC Ordinary Shares

162. Under item 2 of the table in subsection 130-60(1), the first element of the cost base and the reduced cost base of each Approved NOHC Ordinary Share allocated to a Holder will be their cost base in the CPS3 at the time of Conversion divided by the number of Approved NOHC Ordinary Shares they receive for each CPS3.

Acquisition time of the Approved NOHC Ordinary Shares

163. Under subsection 130-60(2), the Approved NOHC Ordinary Shares will be taken to be acquired at the time of the Conversion of the CPS3. This means that the 12 month holding period for the purposes of the CGT discount, as regards the Approved NOHC Ordinary Shares, will run from the acquisition date of the Approved NOHC Ordinary Shares and not from the acquisition of the CPS3.

Section 45

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

165. Pursuant to its dividend and franking policies, BEN will pay fully franked dividends to all its shareholders, including the Holders, to the extent of the franking credits available in its franking account. Furthermore, BEN must pay any Dividend in cash and cannot issue Ordinary Shares to all or some of the Holders in satisfaction of their dividend entitlements in relation to the CPS3.

166. Therefore, section 45 of the ITAA 1936 will not apply to the additional Ordinary Shares acquired on Conversion of the CPS3.

Section 45A

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

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

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

170. Accordingly, it cannot be said that the Holders will derive a greater benefit from capital benefits than other BEN shareholders. Therefore, the allotment of additional Ordinary Shares will not trigger the application of section 45A of the ITAA 1936 and the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that the additional Ordinary Shares acquired on Conversion of the CPS3 will be an unfranked dividend in the hands of the Holders.

Section 45B

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

172. The allotment of additional Ordinary Shares on Conversion of CPS3 will be a scheme under which a capital benefit is provided to the Holders (paragraph 45B(5)(a) of the ITAA 1936).

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

174. The allotment of additional Ordinary Shares will not be in satisfaction of the Holders' entitlement to Dividends, but rather a product of the Conversion of the CPS3 held by the Holders according to the Terms. Consequently, each Holder's interest in the share capital of BEN will not change when the capital benefit is provided. Furthermore, BEN has paid, and has stated it will continue to pay, franked dividends to all its shareholders to the extent of the franking credits available.

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

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/30; TR 2006/10

Subject references:

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

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 6BA
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