Class Ruling

Income tax: Westpac Banking Corporation – Convertible Preference Shares (CPS)

Contents Para

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:

- subsection 44(1) of the *Income Tax Assessment Act 1936* (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;
- former Division 1A of Part IIIAA of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);

- Division 67 of the ITAA 1997;
- Division 104 of the ITAA 1997;
- Subdivision 130-A of the ITAA 1997;
- section 204-30 of the ITAA 1997; and
- Division 207 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies are investors (referred to as Holders) who were allotted perpetual, convertible, unguaranteed and unsecured preference shares issued by Westpac Banking Corporation (Westpac) called Westpac Convertible Preference Shares (Westpac CPS) and who:

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

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

4. The class of entities to which this Ruling applies does not extend to Holders of Westpac CPS who acquired their Westpac CPS otherwise than by initial application under the Prospectus.

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

6. This Ruling does not consider the tax implications of the Redemption, cancellation or buy-back of the Westpac CPS.

7. This Ruling does not consider how the taxation law applies to a Nominated Party who acquires the Westpac CPS under a Transfer Notice.

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

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

Qualifications

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 15 to 57 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

14. This Ruling applies from 23 March 2012 to 30 June 2020. The Ruling continues to apply after 30 June 2020 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

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

- Application for Class Ruling from Westpac dated 17 June 2011;

- Correspondence from the applicant dated 8 July 2011;
- Prospectus dated 24 February 2012 for the issue of Westpac CPS by Westpac (Prospectus); and
- Westpac CPS Terms contained in Appendix B of the Prospectus (Terms) as at 24 February 2012.

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

16. In this Ruling, unless otherwise defined, capitalised terms take on the same meaning as in the Terms.

17. Westpac is an Australian resident company.

18. In the Prospectus, Westpac announced its intention to undertake a capital raising by the issue of 10 million Westpac CPS at a face value of $100 each to raise approximately $1 billion, but with the ability to raise more or less.

19. On 23 March 2012 Westpac allotted 11,893,605 Westpac CPS at $100 each, which raised $1.19 billion.

20. Westpac CPS are listed on the Australian Securities Exchange (ASX) and trade under the ASX code WBCPC.

21. The funds raised from the issue of Westpac CPS will be used for the general business purposes of Westpac in Australia.

22. The Australian Prudential Regulation Authority (APRA) has confirmed that Westpac CPS will be treated as Non-Innovative Residual Tier 1 Capital under APRA's current prudential standard APS 111. APRA has also confirmed that Westpac CPS will also satisfy APRA's interim arrangements for additional Tier 1 capital instruments and will qualify for transition treatment under the Basel III capital adequacy framework.

Main features of Westpac CPS

23. Westpac CPS are fully paid, unsecured, perpetual, non-cumulative preference shares in the capital of Westpac.

24. The issue price of each Westpac CPS (Issue Price) is $100. Westpac CPS are fully paid up to $100 face value on issue.

25. Westpac CPS generally do not have voting rights, except in the limited circumstances described in clause 7 of the Terms.

Dividend calculation

26. Subject to the conditions outlined in paragraphs 29 to 35 of this Ruling, the Holder of each Westpac CPS is entitled to receive on the relevant Dividend Payment Date, a dividend (Dividend) calculated using the formula:

$$\text{Dividend} = \frac{\text{Dividend Rate x Face Value x N}}{365}$$

The Dividend Rate is a floating rate and is determined semi-annually as the sum of the 180 day Bank Bill Rate plus the Margin together multiplied by (1-Tax Rate):

where:

180 Day Bank Bill Rate (expressed as a percentage per annum) means, for each Dividend Period, the 180 Day Bank Bill Rate in the case of the first Dividend Period on the Westpac CPS Issue Date, and, in the case of any other Dividend Period, the first Business Day of each subsequent Dividend Period;

Margin is 3.25% per annum as determined under the Bookbuild;

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

N means the number of days from (but excluding) the Issue Date until (and including) the first Dividend Payment Date or thereafter from (but excluding) each Dividend Payment Date until (and including) the next Dividend Payment Date.

27. The Dividends are expected to be fully franked. However, if any Dividend is not franked or only partially franked, the Dividend will be grossed-up to the extent that the franking percentage of the Dividend is less than 100% (Gross-Up Amounts).

28. As stipulated in clause 3.5 of the Terms, Dividends and Gross-Up Amounts are to be paid in arrears on the following Dividend Payment Dates:

(a) each 31 March and 30 September of each year until the Westpac CPS are Redeemed or Converted; and

(b) on the Redemption Date or the Conversion Date (as the case may be) on which such Westpac CPS are Redeemed or Converted, if that Redemption Date or Conversion Date is not 31 March or 30 September.

Dividend payment conditions

29. A Dividend and Gross-Up Amount must not be paid to the Holders if:

- the Westpac Directors, in their absolute discretion, have not determined that the Dividend and Gross Up Amount is payable;

- the amount of the Dividend and Gross-Up Amount will exceed Distributable Profits, unless APRA otherwise gives its prior written approval; or
- APRA otherwise objects to the payment.

30. Westpac Directors will not determine a Dividend and Gross Up Amount to be payable if, in their opinion, making the payment would result in Westpac becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*.

31. A Dividend and Gross-Up Amount is only payable to those persons registered as the Holders on the Record Date for that Dividend and Gross-Up Amount, respectively.

32. The Dividends and Gross-Up Amounts are non-cumulative and the Holders will have no claim or right to apply for the winding up or administration of Westpac in respect of non-payment. Accordingly, non-payment of all, or part, of a Dividend and Gross-Up Amount does not constitute an event of default by Westpac, and the Holders have no claim against Westpac in respect of non-payment.

33. No interest accrues on any unpaid Dividends and Gross-Up Amounts, and the Holders have no claim or entitlement in respect of interest on any unpaid Dividends and Gross-Up Amounts.

Restrictions in the case of non-payment of Dividends

34. If a Dividend and Gross-Up Amount has not been paid in full within 20 Business Days after the relevant Dividend Payment Date, Westpac must not during a Current Distribution Period:

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

unless:

  - all Westpac CPS have been Converted; or
  - a Special Resolution of the Holders has been passed approving such action,

and APRA does not otherwise object.

35. The restrictions in paragraph 34 of this ruling do not apply in certain limited circumstances stipulated in clause 3.9 of the Terms.

Conversion, Redemption or Transfer of CPS

36. The CPS will mandatorily Convert into Ordinary Shares in the circumstances referred to below. Westpac may Redeem the CPS, or Convert them, in certain circumstances. Westpac CPS Holders have no right to seek or initiate Conversion or Redemption.

Scheduled Conversion

37. Subject to early Conversion transfer or Redemption, Westpac CPS will be converted into Ordinary Shares on the Scheduled Conversion Date. The Scheduled Conversion Date is the earlier of 31 March 2020 and the first Dividend Payment Date after 31 March 2020 on which both Conversion Conditions are satisfied.

Early Conversion/Redemption

38. By issue of an Early Conversion/Redemption Notice, Westpac may elect to Convert or Redeem (or a combination of these):

(i) some or all the Westpac CPS following the occurrence of a Tax Event or Regulatory Event;

(ii) all of the Westpac CPS following the occurrence of an Acquisition Event, provided the Acquisition Event occurs on or after 23 March 2017; or

(iii) some or all of the Westpac CPS on any Optional Conversion/Redemption Date.

39. Early Conversion/Redemption requires the prior written approval of APRA.

40. Holders should not expect that APRA's prior written approval will be given.

Mandatory Conversion upon an Acquisition Event

41. If an Acquisition Event occurs, and Westpac has not issued an Early Conversion/Redemption Notice within a specified time of the Event occurring, and provided the Conversion Conditions are satisfied, Westpac must Convert all Westpac CPS into Ordinary Shares.

Mandatory Conversion upon a Capital Trigger Event

42. Westpac must Convert the CPS if a Capital Trigger Event occurs. This Event will occur when Westpac's Core Tier 1 Capital Ratio, as reported in its most recent relevant disclosure, is equal to or less than 5.125% on a Level 2 basis.

43. Conversion will not be subject to the Conversion Conditions and will operate in precedence to any Conversion contemplated on a Scheduled Conversion Date.

44. Westpac may not Redeem the Westpac CPS following a Capital Trigger Event.

Conversion and issue of Ordinary Shares

45. On the Conversion Date in respect of a Conversion, Westpac CPS will Convert into Ordinary Shares by the variation of the rights and restrictions attaching to the Westpac CPS, such that each Westpac CPS will have all the rights attaching to one fully paid Ordinary Share and will rank equally with all other Ordinary Shares on issue. In addition, all other rights and restrictions conferred on the Westpac CPS under the Terms will generally no longer have any effect. (Conversion and Converted have the corresponding meaning for the purposes of this Ruling.)

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

47. If, following a Capital Trigger Event, the number of Ordinary Shares that a Holder would be entitled to receive for each Westpac CPS would exceed the Maximum Conversion Number, the Holder will instead receive a number of Ordinary Shares equal to the Maximum Conversion Number for each Westpac CPS.

48. Following a Capital Trigger Event, Holders may receive a number of Ordinary Shares that is greater than the Maximum Conversion Number if there is a determination by APRA in relation to Additional Tier 1 Capital securities to that effect.

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

Conversion Conditions

50. Scheduled Conversion, Early Conversion and Conversion upon an Acquisition Event are subject to satisfaction of two Conversion Conditions as defined in clause 4.2 of the Terms.

51. Broadly, the First Conversion Condition is tested 25 Business Days prior to Conversion Date, and requires that the average of the volume weighted average sale prices (VWAP) of Ordinary Shares on that day is greater than 56.12% of the Issue Date VWAP of Ordinary Shares.

52. Broadly, the Second Conversion Condition is tested on the Conversion Date, and requires that the VWAP of Ordinary Shares during the 20 Business Days before Conversion Date is greater than 50.51% of the Issue Date VWAP of Ordinary Shares.

Maximum Conversion Number

53. The Maximum Conversion Number is calculated as the Face Value divided by 50% of the Issue Date VWAP.

Meaning of Redemption

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

Transfer

55. Westpac may elect to have the CPS Transferred instead of Converting them on any Conversion Date, except in the case of a Capital Trigger Event or an Acquisition Event occurring prior to the fifth anniversary of the Issue Date.

56. If Westpac elects to have the CPS Transferred, Westpac will arrange for a third party nominated by Westpac (the Nominated Party) to undertake to purchase from CPS Holders all CPS for $100 each (being the Face Value). On Transfer, CPS Holders will receive $100 for each CPS from the Nominated Party.

Other matters

57. The Ruling is made on the basis that:

(a) Westpac CPS are ‘equity interests’ pursuant to Division 974;

(b) The additional Westpac Ordinary shares issued in the event of Conversion of Westpac CPS will be ‘equity interests’ pursuant to Division 974;

(c) Dividends on Westpac CPS will be frankable distributions pursuant to section 202-40;

(d) Westpac will frank the distributions on the Westpac CPS at the same franking percentage as the benchmark for the franking period in which the payments are made;

(e) During the term of the Transaction, Westpac will be a resident of Australia under the income tax laws of Australia and of no other jurisdiction;

(f) Dividends payable in respect of the Westpac CPS will not be debited to Westpac’s share capital account or its non-share capital account;

(g) No Dividends will be sourced, directly or indirectly, from Westpac’s share capital account;

(h) Westpac expects to have sufficient available profits from which to pay Dividends, and have net assets in excess of ordinary share capital, immediately before the payment of any Dividends payable in respect of the Westpac CPS;

(i) No part of the Dividends will be sourced, directly or indirectly, from unrealised or untaxed profits;

(j) The share capital of Westpac will not become tainted within the meaning of Subdivision 197-A by an issue of the Westpac CPS or the additional Ordinary Shares on Conversion of the Westpac CPS;

(k) Westpac will not differentially frank distributions payable to different Holders of the Westpac CPS according to the tax status of the Holder of those instruments or on any other basis;

(l) Westpac will not differentially frank distributions on the Westpac CPS or any other frankable interest in Westpac according to the tax status of the holders of those instruments or on any other basis;

(m) Westpac intends to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account); and

(n) The accounts of the Westpac Group are prepared in accordance with the applicable accounting standards.

Ruling

Inclusion of Dividends in assessable income

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

Franking credit and entitlement to a tax offset

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

60. Holders will be entitled to a tax offset equal to the franking credit received on the Dividends under subsection 207-20(2).

61. 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, unless specifically excluded from the refundable tax offset rules under section 67-25. Excluded entities include certain trustees and corporate tax entities under subsections 67-25(1A) to 67-25(1D).

Imputation benefits

62. 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 by a Holder in relation to the Dividends payable in respect of Westpac CPS.

Determination under paragraph 177EA(5)(b)

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

Gross up and tax offset rules

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

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

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

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

Cost base of the additional Ordinary Shares

67. 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 Westpac CPS over the Ordinary Shares, including any additional Ordinary Shares, allotted by Westpac pursuant to a Conversion.

Acquisition time of additional Ordinary Shares

68. Under subsection 130-20(3), any additional Ordinary Shares received by a Holder as part of a Conversion are taken to have been acquired at the time Westpac CPS were originally acquired by the Holders, being 23 March 2012.

Allotment of additional Ordinary Shares – Dividend

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

The value of additional Ordinary Shares – Ordinary income

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

Section 45

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

Section 45A

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

Section 45B

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

Commissioner of Taxation
16 May 2012

Appendix 1 – Explanation

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

Inclusion of dividends in assessable income

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

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

76. Dividends paid in respect of Westpac CPS are expected to be fully franked.

77. 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.

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

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

Entitlement to a tax offset

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

81. 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.

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

83. 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).

Imputation benefits – streaming of imputation benefits

84. 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.

85. 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)).

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

87. Westpac CPS will be listed on the ASX and hence will be available for investment by different types of investors. Westpac has indicated that all Holders will receive fully franked Dividends regardless of their tax attributes or their individual tax position. Westpac intends to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account). This includes Dividends payable in respect of the Westpac CPS.

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

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

Determination under paragraph 177EA(5)(b)

90. 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.

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

(a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and

(b) either:

(i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or

(ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and

(c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and

(d) except for this section, the person (the relevant taxpayer) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and

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

92. The Commissioner has considered that the conditions in paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied because:

(a) the issue of Westpac CPS constitutes a scheme for the disposition of a membership interest (paragraph 177EA(3)(a) of the ITAA 1936).

Pursuant to paragraph 177EA(14)(a) of the ITAA 1936, a 'scheme for a disposition of membership interests or an interest in membership interests' includes a scheme that involves the issuing of membership interests.

The issuance of Westpac CPS on the terms set out in the Prospectus is a scheme that involves the issuing of membership interests because, once Westpac CPS are issued, the Holders are members of Westpac and Westpac CPS are not debt interests (sections 960-130 and 960-135);

(b) frankable distributions are expected to be payable to the Holders (paragraph 177EA(3)(b) of the ITAA 1936). The Commissioner accepts that Dividends payable on Westpac CPS will be frankable distributions to the extent that the Dividends on Westpac CPS do not fall within the list in section 202-45;

(c) franked distributions are expected to be paid to the Holders (paragraph 177EA(3)(c) of the ITAA 1936). It is expected that these distributions will be made on a semi-annual basis. Furthermore, Westpac has advised that it will continue its policy of fully franking all frankable distributions made by it, to the extent that franking credits are available in its franking account; and

(d) it is reasonable to expect that an imputation benefit will be received by the relevant taxpayers as a result of distributions made to the Holders, given that Westpac expects to frank the distributions on Westpac CPS (paragraph 177EA(3)(d) of ITAA 1936).

93. 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.

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

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

96. The Commissioner considers that a number of the relevant circumstances of the present arrangement go some way towards indicating a non-incidental purpose of enabling a relevant taxpayer to obtain an imputation benefit. In particular, the calculation of the Dividend by reference to the corporate tax rate, and the Gross-Up Amount that arises if the Dividend is not fully-franked, would be matters going to paragraph (f) of subsection 177EA(17) and are of significance for the ascertainment of the relevant purpose.

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

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

Gross up and tax offset rules

99. Subdivision 207-F can operate to cancel the effect of the gross up and tax offset rules if a distribution is made to an entity in certain circumstances, including where the entity is not a 'qualified person' in relation to the distribution for the purposes of Division IA of former Part IIIAA of the ITAA 1936.

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

101. The holding period rule applies where neither 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 primary qualification period (former paragraph 160APHO(1)(a) of the ITAA 1936).

102. 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).

103. The Holders will be capable of being qualified persons, provided that:

- the Holders, in receipt of Dividends on Westpac CPS, will have held their Westpac CPS at risk for a period of at least 90 days, (excluding the day of acquisition and the day of disposal, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the shares or interest), in the period beginning on the day after the day on which the Holders acquired Westpac CPS and ending on the 90th day after the day on which Westpac CPS 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 Westpac CPS (former paragraph 160APHO(1)(a) and former section 160APHN of the ITAA 1936).

104. 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 IIIAA 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 in relation to payments of Dividends.

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

105. Under the Transaction, Westpac CPS will convert into Ordinary Shares through a variation of the rights attaching to the Westpac CPS. Holders may also receive an allotment of additional Ordinary Shares in Westpac in accordance with the Terms.

106. Subject to satisfaction of the Conversion Conditions, Westpac CPS will Convert into Ordinary Shares on 31 March 2020. If the Conversion Conditions are not satisfied on that date, the Scheduled Conversion Date moves to the next Dividend Payment Date on which the Conversion Conditions are satisfied. Westpac CPS may Convert earlier if Westpac elects to Convert Westpac CPS into Ordinary Shares following the occurrence of certain events defined in the Terms.

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

108. 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)).

109. The mere variation of rights attaching to Westpac CPS and the allotment of an additional number of Ordinary Shares for no consideration under the Terms is not a 'redemption' or 'cancellation' of the share under paragraph 104-25(1)(a). Further, the Conversion of Westpac CPS does not involve Westpac CPS being converted into equity interests under paragraph 104-25(1)(f), but rather Conversion according to the Terms.

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

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

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

113. 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.

114. The Conversion of Westpac CPS involving the allotment of additional Ordinary Shares will result in an adjustment to the cost base and reduced cost base of Westpac Ordinary Shares and any additional Ordinary Shares allotted by Westpac under Subdivision 130-A and section 6BA of the ITAA 1936.

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

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

Cost base of the additional Ordinary Shares

117. 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 Westpac CPS over the Westpac Ordinary Shares and any additional ordinary shares issued by Westpac.

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

119. Pursuant to subsection 6BA(3) of the ITAA 1936, as the additional Ordinary Shares are issued to Holders for no consideration and are not dividend or taken to be a dividend, the issue price of Westpac CPS will be apportioned over the Westpac Ordinary Shares and any additional ordinary shares allotted.

120. 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.

121. 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.

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

Acquisition time of additional Ordinary Shares

123. The Holders are taken to have acquired the additional Ordinary Shares at the time when the Westpac CPS were originally acquired by the Holders, being 23 March 2012 (subsection 130-20(3)).

Allotment of additional Ordinary Shares – Dividend

124. 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.

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

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

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

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

The value of additional Ordinary Shares – ordinary income

129. The allotment of additional Ordinary Shares will be a bonus issue within the meaning of paragraph 254A(1)(a) of the *Corporations Act 2001*, that is, an issue of shares for which consideration is not payable to Westpac. The issue of additional Ordinary Shares will result in a re-expression of the Holder's interest in the share capital of Westpac. Accordingly, the value of any additional Ordinary Shares issued on Conversion of Westpac CPS will not be assessable as ordinary income under subsection 6-5(1) (*Commissioner of Taxation v. McNeil* (2007) 229 CLR 656; 2007 ATC 4223; (2007) 64 ATR 431).

Section 45

130. 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%.

131. Westpac's historical franking policy is to fully frank the dividends it pays. Westpac expects to continue its franking policy and fully frank its dividends for all of its shareholders in the foreseeable future.

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

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

Section 45A

134. 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).

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

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

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

Section 45B

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

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

140. 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.

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

142. 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.

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

Appendix 2 – Detailed contents list

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

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 arrangements
- franking tax offset
- preference shares
- qualified person

Legislative references:

- ITAA 1936 6
- ITAA 1936 44
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45B
- ITAA 1936 177EA
- ITAA 1936 Div 1A of Part IIIAA
- ITAA 1997 6-5
- ITAA 1997 Div 67
- ITAA 1997 104-10
- ITAA 1997 104-25
- ITAA 1997 104-135
- ITAA 1997 104-155
- ITAA 1997 112-30
- ITAA 1997 116-20
- ITAA 1997 116-25
- ITAA 1997 130-20
- ITAA 1997 202-5
- ITAA 1997 202-30
- ITAA 1997 202-40
- ITAA 1997 202-45
- ITAA 1997 204-30
- ITAA 1997 Subdiv 207-B
- ITAA 1997 Subdiv 207-F
- ITAA 1997 220-30
- ITAA 1997 960-120
- ITAA 1997 960-130
- ITAA 1997 960-135
- ITAA 1997 Div 974
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001

Case references:

- Commissioner of Taxation v. McNeil (2007) 229 CLR 656; 2007 ATC 4223; (2007) 64 ATR 431
- Ord Forrest Pty Ltd v. FC of T (1974) 130 CLR 124; 74 ATC 4034; (1974) 4 ATR 230.

Other references:

- Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002.

ATO references

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