



Class Ruling

Income tax: National Australia Bank Limited – issue of convertible preference shares

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① This publication provides you with the following level of protection:

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

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

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

What this Ruling is about

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

Relevant provisions

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

- section 6BA of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) of the ITAA 1936
- section 45 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 177EA of the ITAA 1936
- Division 1A of former Part IIIA 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
- section 109-10 of the ITAA 1997
- section 110-25 of the ITAA 1997
- section 110-55 of the ITAA 1997
- Subdivision 130-A of the ITAA 1997
- Subdivision 130-C of the ITAA 1997
- section 204-30 of the ITAA 1997
- Division 207 of the ITAA 1997

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

Class of entities

3. The class of entities to which this Ruling applies are investors who will be allotted perpetual, convertible, non-cumulative, unguaranteed and unsecured preference shares issued by National Australia Bank Limited (NAB) called convertible preference shares (CPS), and who:

- are residents of Australia within the meaning of subsection 6(1) of the ITAA 1936 during the period in which they hold NAB CPS;
- will not hold their NAB CPS as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1)) – that is, the Holders will hold their NAB CPS broadly on capital account; and
- are not subject to the taxation of financial arrangements (TOFA) rules in Division 230 in relation to gains and losses on their NAB CPS.

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

4. The investors described in the above paragraph are referred to in this Ruling as Holders.

5. The class of entities to which this Ruling applies does not extend to the holders of NAB CPS who do not acquire their NAB CPS by initial application under the Prospectus.

Qualifications

6. This Ruling does not consider the tax implications of the Redemption or Resale of NAB CPS.
7. This Ruling does not consider how the taxation law applies to a Nominated Purchaser who acquires their NAB CPS under the Resale facility.
8. This Ruling does not consider how the gross-up and tax offset rules in Division 207 apply to a Holder that is a partnership or the trustee of a trust, 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 NAB in relation to the issue of the NAB CPS.
10. This Ruling does not deal with how the taxation law applies to Holders who hold their NAB CPS as trading stock or revenue assets.
11. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling. 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 72 of this Ruling.
12. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, or if material amendments are made to the CPS Terms (including amendments under clause 18 of the CPS Terms), then:
- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.
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Date of effect

14. This Ruling applies from 20 March 2013 to 30 June 2021. The Ruling continues to apply after 30 June 2021 to all entities within the specified class who entered into the specified scheme by acquiring their NAB CPS as a result of making an application under the Prospectus. 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 (Greenwoods and Freehills Pty Ltd). The following documents (Transaction Documents), or relevant parts of them, form part of and are to be read with this description:

- Class Ruling application dated 23 January 2013.
- Prospectus relating to the Offer of NAB CPS lodged with the Australian Securities and Investments Commission (ASIC) on 13 February 2013 and Replacement Prospectus lodged with ASIC on 21 February 2013 (Prospectus).
- Terms of the NAB CPS found in Appendix A of the Prospectus (CPS Terms).
- Further correspondence from Greenwoods & Freehills Pty Limited.

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 the meaning that they have in the CPS Terms and the Prospectus.

17. National Australia Bank Limited (NAB) is an Australian resident company. It is an authorised deposit-taking institution (ADI) regulated by the Australian Prudential Regulation Authority (APRA) and other regulatory bodies.

18. NAB is listed on the Australian Securities Exchange (ASX).

The Offer of NAB CPS

19. NAB has invited investors to subscribe for \$1.4 billion (with the ability to raise more or less) of convertible preference shares to be issued by NAB (NAB CPS).

20. The NAB CPS are perpetual fully paid mandatorily convertible preference shares in the capital of NAB.

21. The NAB CPS will be issued by NAB in Australia, that is, the NAB CPS will not be issued by a foreign branch or subsidiary of NAB.

22. The NAB CPS are being offered (the Offer) pursuant to the Prospectus.

23. The Offer has been made to the public at large and is not restricted to a particular category of investors. Any Australian resident is able to purchase the NAB CPS under the Offer and the lead managers are permitted to distribute the CPS prospectus to non-residents in those jurisdictions where the Offer is legally able to be made.

24. The majority of the Holders are expected to be residents of Australia for tax purposes, although some may be non-residents.

25. The classes of applicants for the NAB CPS and how they apply for the NAB CPS are as follows:

- (a) Securityholder Applicant – a holder of NAB Ordinary Shares and certain other capital instruments shown on the Register with an address in Australia and who applies through the Securityholder Offer
- (b) General Applicant – a member of the general public who applies under the General Offer
- (c) Broker Firm Applicant – a client of a Syndicate Broker invited to participate through the Broker Firm Offer
- (d) Institutional Investor – an institutional investor who applies to participate by contacting the sole Arranger and Lead Manager.

NAB has applied for the NAB CPS to be listed on the ASX following completion of the Offer.

26. The date of the contract of allotment for the NAB CPS will be 20 March 2013.

Reasons for issuing the NAB CPS

27. The Offer has been made as part of NAB's ongoing capital management strategy within the regulatory capital guidelines prescribed by APRA. The issue of the NAB CPS will be a new capital raising and will not be refinancing any securities that NAB currently has on issue. NAB will use the proceeds for general corporate purposes.

28. APRA has confirmed that the NAB CPS will qualify as Additional Tier 1 capital under APRA's new Basel III Prudential Standards that apply from 1 January 2013.

Forecasted franking account balance

29. NAB expects to pay fully franked dividends in the foreseeable future to all the holders of interests in NAB that are capable of giving rise to frankable distributions, including the Holders and the holders of Ordinary Shares, to the extent of the franking credits in its franking account.

Terms of the NAB CPS

30. The NAB CPS are issued, and may be Redeemed, Converted or Resold, by NAB according to the CPS Terms. The Issue Price of each NAB CPS is A\$100.

Dividend Payment Dates

31. Subject to the CPS Terms, NAB shall pay a dividend in respect of a NAB CPS on the following dates (each a Dividend Payment Date):

- (a) each 20 March, 20 June, 20 September, 20 December commencing on 20 June 2013 until (but not including) the date on which the CPS is Converted or Redeemed in accordance with the CPS Terms; and
- (b) each date on which a Conversion, Redemption or Resale of that NAB CPS occurs in accordance with the CPS Terms.

32. A Dividend is only payable on a Dividend Payment Date to those persons registered as Holders on the Record Date for that Dividend.

Calculation of Dividends on NAB CPS

33. The Dividend payable in respect of each NAB CPS on a Dividend Payment Date is calculated in accordance with the following formula:

$$\text{Dividend} = \frac{\text{Dividend Rate} \times \text{A\$100} \times \text{N}}{365}$$

where:

N is the number of days in the Dividend Period.

Dividend Rate (expressed as a percentage per annum) is calculated using 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 90 days

which average rate is displayed on Reuters page BBSW (or any page which replaces that page) on the Issue Date in the case of the first Dividend Period, and in the case of any other Dividend Period the first Business Day of the Dividend Period or, if there is a manifest error in the calculation of that average rate or that average rate is not displayed by 10:30am (Australian eastern standard time) on that date, the rate specified in good faith by NAB at or around that time on that date having regard, to the extent possible, to:

- (a) the rates otherwise bid and offered for bank bills of a term of 90 days or for bank funds of that tenor displayed on Reuters page BBSW (or any page which replaces that page) at that time on that date; or
- (b) if bid and offer rates for bank bills of a term of 90 days are not otherwise available, the rates otherwise bid and offered for bank funds of that tenor at or around that time on that date.

Margin (expressed as a percentage per annum) means the margin specified in, or determined in accordance with, the Bookbuild.

Tax Rate (expressed as a decimal) means the Australian corporate tax rate applicable to the franking account of NAB on the relevant Dividend Payment Date.

Franking adjustments

34. The Dividends are expected to be fully franked. However, if a Dividend is not franked to 100%, the Dividend will be grossed-up to the extent that the franking percentage of the Dividend is less than 100%, as determined by the formula in clause 2.5 of the CPS Terms.

Conditions to payment of Dividends

35. A Dividend will be paid only if:

- (a) the Directors of NAB in their sole discretion resolve to pay the relevant Dividend on the relevant Dividend Payment Date; and
- (b) a Payment Condition does not exist on the relevant Dividend Payment Date.

The term 'Payment Condition' is defined in clause 24.1 of the CPS Terms.

Dividends are non-cumulative

36. Dividends are non-cumulative. If all or any part of a Dividend is not paid in full because of the restrictions in clause 2.6 of the CPS Terms or for any other reason:

- (a) NAB has no liability to pay the unpaid amount of the Dividend;

- (b) Holders have no claim or entitlement in respect of such non-payment; and
- (c) such non-payment does not constitute an event of default.

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

Restrictions in the case of non-payment of Dividends

37. If a Dividend on a NAB CPS has not been paid in full (Relevant Dividend) on a Dividend Payment Date (Relevant Dividend Payment Date) for any reason, NAB must not, unless approved by an Ordinary Resolution, until and including the Dividend Payment Date following the Relevant Dividend Payment Date:

- (a) declare, determine to pay or pay any Ordinary Share Dividend; or
- (b) undertake any Buy-Back or Capital Reduction,

unless the Relevant Dividend is paid in full within 3 Business Days of the Relevant Dividend Payment Date.

Mandatory Conversion

38. Subject to the Mandatory Conversion Conditions being satisfied, all the NAB CPS must Convert into Ordinary Shares on the Mandatory Conversion Date.

39. The Mandatory Conversion Date will be the first to occur of the following dates (each a Relevant Mandatory Conversion Date) on which the Mandatory Conversion Conditions are satisfied:

- (a) 22 March 2021 (the Scheduled Mandatory Conversion Date); or
- (b) the first Dividend Payment Date after the Scheduled Mandatory Conversion Date (a Subsequent Mandatory Conversion Date).

Mandatory Conversion Conditions

40. The Mandatory Conversion Conditions for each Relevant Mandatory Conversion Date are:

- (a) the volume weighted average price (VWAP) of NAB Ordinary Shares on the 25th Business Day immediately preceding (but not including) the Relevant Mandatory Conversion Date is greater than 56% of the Issue Date VWAP;

- (b) the VWAP of NAB Ordinary Shares 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 50.51% of the Issue Date VWAP; and
- (c) no Delisting Event applies in respect of the Relevant Mandatory Conversion Date.

Mandatory Conversion on Loss Absorption Event

41. Clause 4.4 of the CPS Terms states that on the date on which a Loss Absorption Event occurs, NAB must determine the number of NAB CPS that will convert into Ordinary Shares. On the Loss Absorption Event Conversion Date, the relevant number of NAB CPS will Convert immediately and irrevocably (paragraph 4.4(c) of the CPS Terms).

42. Conversion on account of a Loss Absorption Event is not subject to the Mandatory Conversion Conditions (paragraph 4.7(a) of the CPS Terms).

43. According to clause 4.1, a Loss Absorption Event is each of:

- (a) a Common Equity Trigger Event; and
- (b) a Non-Viability Trigger Event

44. Under clause 4.2, a Common Equity Trigger Event occurs when either or both of the Common Equity Tier 1 Ratio in respect of the NAB Level 1 Group and the NAB Level 2 Group as determined by NAB or APRA at any time is equal to or less than 5.125%.

45. If a Common Equity Trigger Event occurs, NAB must convert into Ordinary Shares or write-off:

- (a) all Relevant Tier 1 Capital Instruments; or
- (b) a proportion of the Relevant Tier 1 Capital Instruments if APRA is satisfied that conversion or write-off of that proportion will have the result that each of the Common Equity Tier 1 Ratio in respect of the NAB Level 1 Group and the Common equity Tier 1 Ratio in respect of the NAB Level 2 Group is at a percentage above 5.125% determined by NAB for that ratio.

46. Under clause 4.3, a Non-Viability Trigger Event means APRA has provided a written determination to NAB that the conversion into NAB Ordinary Shares or write off of Relevant Tier 1 Capital Instruments in accordance with their terms or by operation of law is necessary because:

- (a) without the conversion or write off, APRA considers that NAB would become non-viable; or

- (b) without a public sector injection of capital into, or equivalent capital support with respect to, NAB, APRA considers that NAB would become non-viable.

47. If a Non-Viability Trigger Event occurs, NAB must convert into Ordinary Shares or write-off:

- (a) all Relevant Tier 1 Capital Instruments; or
- (b) a proportion of the Relevant Tier 1 Capital Instruments if APRA is satisfied that conversion or write-off of that proportion will be sufficient to ensure that NAB does not become non-viable.

48. Clause 4.5 states that where on the Loss Absorption Event Conversion Date an Inability Event subsists (defined in clause 24.1 of the CPS Terms to mean that NAB is prevented by applicable law or order of any court or action of any government authority or any other reason from Converting the NAB CPS), and Conversion has not been effected within 5 days after the Loss Absorption Event Conversion Date, then Conversion on account of the Loss Absorption Event will not apply and those NAB CPS will be Written Off. This means that, in respect of a NAB CPS and a Loss Absorption Event Conversion Date:

- (a) the NAB CPS will not be Converted in respect of the Loss Absorption Event Conversion Date and will not be Converted, Redeemed or Resold under the CPS Terms on any subsequent date; and
- (b) on and from the sixth day after the Loss Absorption Event Conversion Date, the Holders irrevocably agree to accept that the rights attaching to the NAB CPS are automatically varied so that broadly:
 - (i) in a winding-up of NAB, in place and in satisfaction of the Liquidation Amount, the Holders will receive an amount equal to the sum which would have been paid in respect of the NAB CPS out of the surplus available to shareholders in a winding-up as if the NAB CPS were the Conversion Number of Ordinary Shares; and
 - (ii) in place of Dividends payable under Clause 2 but subject to the Terms and the requirements of APRA applicable to the payment of dividends on Ordinary Shares, a non-cumulative dividend is payable to the Holders in respect of the NAB CPS if and when a dividend is paid on Ordinary Shares, in an amount determined as if the NAB CPS were the Conversion Number of Ordinary Shares.

Mandatory Conversion on Acquisition Event

49. Clause 5.1 states that if an Acquisition Event occurs, NAB must convert all of the NAB CPS on the Acquisition Conversion Date.

50. Clause 24.1 defines an Acquisition Event as, broadly, any one of the following events:

- (a) a takeover bid is made to acquire all or some of the Ordinary Shares and such offer is, or becomes, unconditional, all regulatory approvals have been obtained and either the bidder has at any time during the offer period a relevant interest in more than 50% of the Ordinary Shares on issue or a majority of NAB Directors (who are eligible to do so) recommend acceptance of the takeover offer; or
- (b) a court approves a scheme of arrangement under Part 5.1 of the *Corporations Act 2001*, which when implemented will result in a person having a relevant interest in more than 50% of the Ordinary Shares,

provided that it is not a NOHC Event.

Optional Conversion by NAB

51. Clause 6.1 of the CPS Terms states that NAB may, with APRA's prior written approval, elect to Convert:

- (a) all or some NAB CPS on an Optional Conversion Date following the occurrence of a Tax Event or a Regulatory Event;
- (b) all or some NAB CPS on an Optional Conversion Date following the occurrence of a Potential Acquisition Event; or
- (c) all or some NAB CPS on 20 March 2019.

Conversion mechanics

52. Clause 7.1 of the CPS Terms states that Conversion involves the following:

- (a) each NAB CPS that is being Converted will Convert into one Ordinary Share on the Conversion Date; and
- (b) each Holder will be allotted, for no additional consideration, an additional number of Ordinary Shares for each NAB CPS that is being Converted on the Conversion Date equal to one less than the Conversion Number, where the Conversion Number is the lesser of the number calculated according to a formula and the Maximum Conversion Number (itself calculated according to a formula).

53. Paragraph 7.1(d) states that a NAB CPS, upon Conversion, confers all of the rights attaching to one NAB Ordinary Share. All other rights conferred or restrictions imposed on that NAB CPS under the CPS Terms will no longer have effect (except for accrued rights). The Ordinary Share resulting from the Conversion will rank equally with all other Ordinary Shares. Conversion does not constitute a redemption, buy-back, cancellation or termination of NAB CPS or an issue, allotment or creation of a new Ordinary Share (other than the allotment of an additional number of Ordinary Shares under paragraph 7.1(b)).

54. Clause 7.9 states that each Ordinary Share issued or arising upon Conversion ranks equally with all other fully paid Ordinary Shares.

55. Under clause 7.12, if on a Conversion Date (other than a Loss Absorption Event Conversion Date) an Ordinary Share is not issued or delivered in respect of a NAB CPS, that NAB CPS remains on issue (and will continue to entitle the Holder to Dividends in accordance with clause 2) until the Ordinary Share is issued to the Holder or the NAB CPS is Redeemed or Resold, and a Holder shall have no claim in respect of that failure other than for specific performance of the obligation to issue or deliver the Ordinary Shares. This clause does not affect the obligation of NAB to issue or deliver the Ordinary Shares when required in accordance with the CPS Terms.

56. Under clause 7.13, if NAB CPS of a Holder are required to be Converted and the Holder has notified NAB that it does not wish to receive Ordinary Shares as a result of Conversion, on the Conversion Date, the Holder's rights in relation to each such NAB CPS being Converted are immediately and irrevocably terminated and NAB will issue the Conversion Number of Ordinary Shares to a nominee to hold on trust for sale for the benefit of the relevant Holder. At the first opportunity to sell the Ordinary Shares, the nominee will arrange for their sale and pay the proceeds less selling costs to the relevant Holder.

Optional Redemption by NAB

57. Clause 8.1 of the CPS Terms states that NAB may, with APRA's prior written approval, elect to Redeem:

- (a) all or some NAB CPS on a Redemption Date following the occurrence of a Tax Event or a Regulatory Event; or
- (b) all or some NAB CPS on 20 March 2019.

58. Clause 24.1 defines 'Redemption' to mean the redemption, buy-back (other than an on-market buy-back within the meaning of the *Corporations Act*) or reduction of capital, or any combination of such actions in accordance with the CPS Terms.

Redemption mechanics

59. Clause 9.2 of the CPS Terms states that the NAB CPS will be Redeemed by payment on the Redemption Date of an amount equal to the Issue Price to the Holder. Under clause 9.3, where the Redemption involves a buy-back of the NAB CPS, the Directors may determine that the consideration payable for each NAB CPS that is bought back will include an amount (in addition to the Issue Price) equal to a Dividend calculated in accordance with clause 2 for the Dividend Period ending on (but not including) the Redemption Date.

Optional Resale

60. Clause 10.1 of the CPS Terms states that NAB may, with APRA's prior written approval, elect to Resell:

- (a) all or some NAB CPS on a Resale Date following the occurrence of a Tax Event or a Regulatory Event; or
- (b) all or some NAB CPS on 20 March 2019.

Resale mechanics

61. Clause 11.2 of the CPS Terms states that if NAB elects to Resell NAB CPS, NAB must appoint one or more Nominated Purchasers for the Resale on such terms as may be agreed between NAB and the Nominated Purchasers.

62. Clause 11.4 states that each Holder on the Resale Date is taken irrevocably to offer to sell the NAB CPS to the Nominated Purchaser(s) on the Resale Date for the Resale Price. Resale Price means, for a NAB CPS, a cash amount equal to its Issue Price.

63. Clause 11.5 states that on the Resale Date subject to payment by the Nominated Purchaser of the Resale Price to the Holders, all right, title and interest in such NAB CPS (excluding the right to any Dividend payable on that date) will be transferred to the Nominated Purchaser free from Encumbrances.

Ranking and subordination

64. Under clause 16.1 of the CPS Terms, NAB CPS will rank in respect of payment of Dividends:

- (a) in priority to Ordinary Shares;
- (b) equally and without any preference amongst themselves; and

- (c) equally with each other preference share that NAB has issued or may issue that has the same identifying number as provided in the Constitution with respect to priority of payments of dividends otherwise than in a winding up and with each of the other securities and instruments that NAB has issued or may issue that by their terms rank equally with respect to priority of payments of dividends, distributions or similar payments, otherwise than in a winding up.

65. Clause 16.2 states that in a winding up of NAB, a NAB CPS confers upon its Holder the right to payment in cash of an amount equal to the Liquidation Amount out of the surplus (if any) available for distribution to shareholders, but no further or other right to participate in the assets of NAB or a return of capital in the winding up. Liquidation Amount is defined in clause 24.1 to be the sum of A\$100 plus the amount of any Dividend resolved to be paid but unpaid.

66. Clause 16.3 states that NAB CPS rank in respect of payment of the Liquidation Amount in a winding up of NAB:

- (a) in priority to the claims of the holders of Ordinary Shares;
- (b) equally and without any preference amongst themselves;
- (c) equally with the claims of the holders of Equal Ranking Instruments; and
- (d) junior to the claims of all creditors of NAB, including depositors, other than creditors expressed to rank equally with the NAB CPS in a winding up.

Voting rights

67. The NAB CPS generally do not have voting rights, except in the limited circumstances as described in clause 17.2 of the CPS Terms.

Substitution of Approved NOHC as issuer of ordinary shares

68. Clause 19 of the CPS Terms provides for the substitution of an Approved NOHC as the issuer of ordinary shares on the Conversion of the NAB CPS. Clause 24.1 defines a NOHC as a non-operating holding company within the meaning of the *Banking Act 1959*.

69. Clause 24.1 defines a NOHC Event as an event which would otherwise be an Acquisition Event which is initiated by the Directors, acting as a board, and the result of which is that the ultimate holding company of NAB would be a NOHC (meaning a non-operating holding company within the meaning of the *Banking Act*).

70. NAB may give a notice to the Holders before the NOHC Event occurs specifying the amendments to the CPS Terms which will be made to effect the substitution of an Approved NOHC as the issuer of ordinary shares of the Approved NOHC to Holders on Conversion of the NAB CPS. This means that, on Conversion, each NAB CPS that is being Converted will be automatically transferred by each Holder to the Approved NOHC (or another entity which meets the stated criteria) and each Holder will be issued a number of ordinary shares in the capital of the Approved NOHC equal to the Conversion Number.

Other matters

71. The Ruling is made on the basis that:

- (a) The Terms represent a complete and accurate description of the transaction; are intended by the parties to have their legal effect; and will be implemented according to their terms.
- (b) During the term of the transaction, NAB will be a resident of Australia under the income tax law of Australia and of no other jurisdiction.
- (c) All parties to the transaction are dealing with each other on arm's length terms and fair value consideration will be provided by the Holders to acquire the NAB CPS.
- (d) The NAB CPS will be 'equity interests' in NAB pursuant to Division 974.
- (e) Dividends on the NAB CPS will be frankable distributions pursuant to section 202-40.
- (f) NAB will frank each Dividend on the NAB CPS (being a frankable distribution) at the same franking percentage as the NAB benchmark for the franking period in which the frankable distribution is made.
- (g) NAB expects to have sufficient available profits from which to pay Dividends, and to have net assets in excess of ordinary share capital, immediately before the payment of any Dividends payable in respect of the NAB CPS.
- (h) Dividends payable in respect of the NAB CPS will not be sourced, directly or indirectly, from NAB's share capital account or its non-share capital account.
- (i) The share capital account of NAB will not become tainted within the meaning of Subdivision 197-A by the issue of the NAB CPS or the allotment of additional Ordinary Shares on Conversion of the NAB CPS.

- (j) The majority of the Holders are expected to be residents of Australia for income tax purposes, although some may be non-residents.
- (k) For the purposes of determining whether a Holder is a 'qualified person' in relation to the Dividends under Division 1A of former Part IIIAA of the ITAA 1936, neither a Holder nor an associate of a Holder has taken any 'positions' (within the meaning of former section 160APHJ of the ITAA 1936) (apart from holding the NAB CPS) in relation to their NAB CPS.
- (l) A Holder or an associate of a Holder has not made, is not under an obligation to make, or is not likely to make, a related payment (defined in former section 160APHN of the ITAA 1936) in respect of any of the Dividends.
- (m) The Holders in receipt of Dividends on the NAB CPS will have held their NAB CPS for a period of at least 90 days (excluding the day of acquisition and the day of disposal of their NAB CPS, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the NAB CPS) within the primary qualification period in relation to at least one of the Dividends, which period begins on the day after the day on which the Holder acquired their NAB CPS and ends on the 90th day after the day on which the NAB CPS became ex dividend.
- (n) The dividend payout ratios and the franking credits in relation to the Ordinary Shares and other preference share capital of NAB are not expected to change as a result of the issue of the NAB CPS.
- (o) NAB has paid fully franked dividends on all of the interests in NAB that are capable of giving rise to frankable distributions for several years.
- (p) On the date of the Conversion of the NAB CPS into Ordinary Shares, the rights and obligations attached to those Ordinary Shares will be materially the same as those contained in the Constitution of NAB as at the time of issue of the NAB CPS.
- (q) By the date of the Conversion of the NAB CPS, if an Approved NOHC is the ultimate holding company of NAB, the Approved NOHC ordinary shares will be equity interests in the Approved NOHC pursuant to Division 974.
- (r) NAB will not differentially frank distributions payable to different Holders according to the tax status of the Holder or on any other basis.

- (s) NAB will not differentially frank distributions on the NAB CPS, or any other interest in NAB that is capable of giving rise to a frankable distribution, according to the tax status of the holders of those instruments or on any other basis.
- (t) The accounts of the NAB group are, and will continue to be, prepared in accordance with the applicable accounting standards.

Ruling

Acquisition time of the NAB CPS

72. Under item 2 of the table in section 109-10, a Holder will acquire their NAB CPS on 20 March 2013, being the date the contract for the allotment of the NAB CPS was entered into.

Cost base and reduced cost base of the NAB CPS

73. Under subsections 110-25(2) and 110-55(2), the first element of the cost base and reduced cost base of each NAB CPS will be \$100.

Inclusion of Dividends and franking credits in assessable income

74. The Holders must include in their assessable income all Dividends received in respect of their NAB CPS under subparagraph 44(1)(a)(i) of the ITAA 1936, and the amount of the franking credit on those Dividends under subsection 207-20(1), unless Subdivision 207-D applies.

Entitlement to a tax offset

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

76. The Holders who are entitled to a franking credit tax offset under Division 207 will be subject to the refundable tax offset rules in Division 67. Certain trustees and corporate tax entities are excluded from the refundable tax offset rules under section 67-25.

Imputation benefits – streaming

77. 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 the Holders in respect of the Dividends paid on the NAB CPS.

Section 177EA of the ITAA 1936

78. 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 respect of the Dividends paid on the NAB CPS.

Gross-up and tax offset

79. Section 207-145 will not apply to the Dividends received by the Holders in respect of the NAB CPS. Accordingly, section 207-145 will not adjust the Holders' assessable income to exclude the amount of the franking credit on the Dividends, nor will it deny the tax offset to which the Holders would otherwise be entitled.

Qualified person and the Resale facility

80. For the purpose of determining whether a Holder is a 'qualified person' in relation to the Dividends under Division 1A of former Part IIIA of the ITAA 1936, the Resale facility, of itself, will not affect a Holder's risks of loss or opportunities for gain in respect of the NAB CPS. This is because the Resale facility does not constitute a separate position (former sections 160APHM and 160APHJ of the ITAA 1936).

Conversion of each NAB CPS – CGT implications

81. The Conversion of each NAB CPS, which consists of the variation of the rights attached to a NAB CPS and the allotment of additional Ordinary Shares, will not result in any CGT event happening.

82. Specifically, CGT event C2 in section 104-25 will not happen upon the Conversion of each NAB CPS. Furthermore, CGT event H2 in section 104-155 will not happen upon the Conversion of each NAB CPS because it includes the allotment of additional Ordinary Shares, which results in an adjustment being made to the cost base and reduced cost base of each NAB CPS.

NAB CPS that are Written Off – CGT implications

83. CGT event H2 in section 104-155 will happen when the NAB CPS are Written Off. However, a Holder will not make a capital gain or a capital loss from CGT event H2 happening as there will be no capital proceeds or incidental costs incurred because of the NAB CPS being Written Off.

84. No other CGT event will happen when the NAB CPS are Written Off.

Cost base of the additional Ordinary Shares

85. Section 6BA of the ITAA 1936 and Subdivision 130-A of the ITAA 1997 will apply to apportion the first element of the cost base and reduced cost base of each NAB CPS over the converted NAB CPS (being one Ordinary Share in NAB) and any additional Ordinary Shares allotted by NAB as a result of the Conversion of the NAB CPS.

Acquisition time of the additional Ordinary Shares

86. Under item 1 of the table in subsection 130-20(3), any additional Ordinary Shares acquired by a Holder as part of the Conversion of the NAB CPS will be taken to have been acquired at the time when the NAB CPS were originally acquired by the Holders, being 20 March 2013.

Allotment of the additional Ordinary Shares – dividend

87. The allotment of any additional Ordinary Shares on the Conversion of the NAB CPS will not constitute a dividend within the meaning of subsection 6(1) of the ITAA 1936, or be taken to be a dividend under subsection 6BA(5) of the ITAA 1936.

The value of the additional Ordinary Shares – ordinary income

88. The value of any additional Ordinary Shares allotted on the Conversion of the NAB CPS will not be included as ordinary income in the assessable income of any of the Holders under subsection 6-5(1).

Section 45 of the ITAA 1936

89. Section 45 of the ITAA 1936 will not apply to treat the value of the additional Ordinary Shares allotted to the Holders on the Conversion of the NAB CPS as an unfranked dividend paid by NAB to the Holders.

Section 45A of the ITAA 1936

90. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefit provided to the Holders when the additional Ordinary Shares are allotted to them on the Conversion of the NAB CPS. Therefore, no part of the value of the additional Ordinary Shares will be an unfranked dividend in the hands of the Holders.

Section 45B of the ITAA 1936

91. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefit provided to the Holders when the additional Ordinary Shares are allotted to them on the Conversion of the NAB CPS. Therefore, no part of the value of the additional Ordinary Shares will be an unfranked dividend in the hands of the Holders.

Amendment of the CPS Terms to substitute an Approved NOHC

92. CGT event H2 in section 104-155 will happen if the CPS Terms are amended to effect the substitution of an Approved NOHC as the issuer of ordinary shares to the Holders on Conversion of the NAB CPS.

93. However, a Holder will not make a capital gain or a capital loss from CGT event H2 happening as there will be no capital proceeds or incidental costs incurred because of the amendment of the CPS Terms.

Conversion of each NAB CPS and the issue of ordinary shares in an Approved NOHC – CGT implications

94. Where an Approved NOHC becomes the ultimate holding company of NAB, the Conversion of each NAB CPS and the issue of Approved NOHC ordinary shares to the Holders will result in CGT event C2 happening (section 104-25). This is because it is the conversion of a convertible interest.

95. However, the capital gain or capital loss that a Holder makes from CGT event C2 is disregarded under subsection 130-60(3). For subsection 130-60(3) to apply, this Ruling is made on the basis that the Approved NOHC ordinary shares will be equity interests in the Approved NOHC pursuant to Division 974.

Cost base of the Approved NOHC ordinary shares

96. 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 issued to the Holders will be calculated as the cost base of their NAB CPS at the time of Conversion divided by the number of Approved NOHC ordinary shares they receive for each NAB CPS.

Acquisition time of the Approved NOHC ordinary shares

97. Under subsection 130-60(2), the Holders will be taken to have acquired the Approved NOHC ordinary shares at the time of the Conversion of the NAB CPS.

Commissioner of Taxation

6 March 2013

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 NAB CPS

98. Where a company issues or allots equity interests in the company, the equity interests are acquired when the contract is entered into or, if there is no contract, when the equity interests are issued or allotted (item 2 of the table in section 109-10).

99. The NAB CPS are equity interests in NAB. When an investor's application for a certain number of the NAB CPS is accepted by NAB, this leads to the formation of a contract for the allotment of the NAB CPS to the investor (who will become a Holder). Under item 2 of the table in section 109-10, a Holder will acquire their NAB CPS on 20 March 2013, being the date on which the contract for the allotment of the NAB CPS will be entered into.

Cost base and reduced cost base of the NAB CPS

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

101. The Issue Price of each NAB CPS is \$100. Accordingly, when the NAB CPS are issued, the first element of a Holder's cost base and reduced cost base of each NAB CPS will be \$100.

Inclusion of Dividends and franking credits in assessable income

102. 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.

103. 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 in 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.

104. Dividends paid in respect of the NAB CPS will be a distribution of money made by NAB, and will not be sourced, either directly or indirectly, from NAB's share capital account. Therefore, the Dividends are a 'dividend' under the income tax law. Dividends paid in respect of the NAB CPS will be paid out of NAB's profits. Accordingly, the Holders must include all Dividends they receive in respect of their NAB CPS in their assessable income under section 44 of the ITAA 1936.

105. NAB expects that the Dividends paid in respect of the NAB CPS will be franked.

106. Under the Australian imputation system, where an Australian resident company makes a franked distribution directly to a shareholder, the assessable income of the shareholder must also include the amount of the franking credit on the distribution under subsection 207-20(1). The inclusion of both the dividend and the attached franking credit in a shareholder's assessable income is known as 'grossing-up' the dividend.

107. Accordingly, the Holders must include in their assessable income the amount of the franking credit on the Dividends that are received by the Holders.

Entitlement to a tax offset

108. Under subsection 207-20(2), the Holders are entitled to a tax offset equal to the franking credit on the Dividends.

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

110. Accordingly, the Holders will be subject to the refundable tax offset rules unless they are a type of entity that is specifically excluded under section 67-25.

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

Imputation benefits – streaming

112. 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.

113. Section 204-30 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 applies where a corporate tax entity 'streams' the payment of distributions, or the payment of distributions and the giving of other benefits, to its members in such a way that:

- (a) an imputation benefit is, or apart from this section would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a));
- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)); and
- (c) the other 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)).

114. Relevantly, if section 204-30 applies, the Commissioner has a discretion under subsection 204-30(3) to make a written determination either:

- (a) that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a)); or
- (b) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination (paragraph 204-30(3)(c)).

115. 'Streaming' is not defined for the purposes of section 204-30. However, the Commissioner understands 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).

116. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The words 'derive a greater benefit from franking credits' are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits. The imputation benefit for resident shareholders is in the form of a tax offset (paragraph 204-30(6)(a)), and for non-resident shareholders is in the form of not being liable to pay dividend withholding tax (paragraph 204-30(6)(e)). The resident shareholders derive a greater benefit from franking credits than the non-resident shareholders.

117. The NAB CPS will be listed on the ASX and hence will be available for investment by different types of investors. NAB expects to pay fully franked dividends in the foreseeable future to all the holders of interests in NAB that are capable of giving rise to frankable distributions, including the Holders, to the extent of the franking credits in its franking account. The dividend payout ratios and franking credits in relation to the Ordinary Shares and other preference share capital of NAB are not expected to change as a result of the issue of the NAB CPS. Accordingly, it cannot be said that NAB will selectively direct the flow of franked distributions to those members who could most benefit from the franking credits.

118. Further, the additional Ordinary Shares allotted on the Conversion of the NAB CPS will not attract the application of section 204-30 because the additional Ordinary Shares will not constitute a 'distribution' (as defined in section 960-120) and the additional Ordinary Shares will not affect NAB's policy of paying fully franked dividends.

119. Based on the information provided, the Commissioner does not conclude that the requisite element of streaming exists in relation to the franked distributions to be paid by NAB to the Holders. Accordingly, based on the information provided, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits that are to be received by the Holders in respect of the Dividends paid on the NAB CPS.

Section 177EA of the ITAA 1936

120. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes designed to obtain imputation benefits. In essence, it applies to schemes for the disposition of shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares.

121. Where section 177EA applies, the Commissioner has a discretion pursuant to subsection 177EA(5) of the ITAA 1936 to make a determination to either:

- debit the company's franking account pursuant to paragraph 177EA(5)(a) of the ITAA 1936; or
- deny the imputation benefit on the distribution that flowed directly or indirectly to each shareholder pursuant to paragraph 177EA(5)(b) of the ITAA 1936.

122. Subsection 177EA(3) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies if:

- (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.

123. Under this arrangement, the 'relevant taxpayer' is a Holder of the NAB CPS and the scheme comprises the circumstances surrounding the issue of the NAB CPS to Holders who acquired their NAB CPS by initial application under the Prospectus.

124. In the present case the conditions of paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied.

- (a) The issue of the NAB CPS (being membership interests in NAB, a corporate tax entity) pursuant to the Prospectus is a scheme for a disposition of membership interests in a corporate tax entity.
- (b) The Dividends on the NAB CPS are each a frankable distribution that is expected to be payable to Holders in respect of their NAB CPS.
- (c) The Dividends on the NAB CPS are each expected to be a franked distribution.
- (d) Holders could reasonably be expected to receive imputation benefits as a result of the Dividends on the NAB CPS.

125. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of NAB, its shareholders (including the Holders) or any other relevant party who entered into or carried out the scheme or any part of the scheme, there is a purpose (other than an incidental purpose) of enabling the Holders to obtain an imputation benefit.

126. In arriving at a conclusion, the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of circumstances which, taken individually or collectively, could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may not be present at any one time in any one scheme.

127. NAB has advised that it will issue the NAB CPS as part of its ongoing capital management strategy to support its general corporate business and to provide the NAB Group with Tier 1 capital as required by APRA for capital adequacy purposes.

128. Based on the information provided and the qualifications set out in this Ruling, and having regard to all of the relevant circumstances of the scheme, the Commissioner has concluded that the purpose of enabling the Holders to obtain imputation benefits is *not* more than incidental to NAB's purpose of raising Tier 1 Capital to meet its capital adequacy requirements.

129. Accordingly, 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 that are to be received by the Holders in respect of the Dividends paid on the NAB CPS.

Gross-up and tax offset

130. 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. Section 207-145 is relevant to the Holders that are the subject of this Ruling.

131. Pursuant to subsection 207-145(1), this adjustment will occur where a franked distribution is made to an entity in one or more of the following circumstances:

- The entity is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of former Part IIIA of the ITAA 1936 (paragraph 207-145(1)(a) of the ITAA 1997).
- The Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(b) of the ITAA 1997).
- The Commissioner has made a determination under paragraph 204-30(3)(c) of the ITAA 1997 that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(c) of the ITAA 1997).

- The distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d) of the ITAA 1997).

132. The main test of what constitutes a 'qualified person' in relation to a franked distribution, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, is known as the holding period rule. This test is in former subsection 160APHO(1) of the ITAA 1936, which states:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a qualified person in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, or is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

133. Former subsection 160APHO(2) of the ITAA 1936, referred to in the preceding paragraph, requires the taxpayer to hold the shares or interest in shares for at least 45 days if the shares are not preference shares, or at least 90 days if the shares are preference shares.

134. As the NAB CPS are 'preference shares' (as defined in the former section 160APHD of the ITAA 1936), a Holder is required to hold the shares on which a dividend has been paid for a continuous period of at least 90 days during the relevant qualification period.

135. In determining whether they hold the shares for at least 90 days during the relevant qualification period, an entity does not count the day on which the shareholder acquired the shares. If the shareholder has disposed of the shares, an entity does not count the day on which the disposal occurred.

136. Furthermore, any days on which the shareholder has materially diminished risks of loss or opportunities for gain in respect of the shares (within the meaning of former sections 160APHM and 160APHJ of the ITAA 1936) are to be excluded. The exclusion of those days is not taken to break the continuity of the period for which the shareholder held the shares.

137. Under former subsection 160APHM(2) of the ITAA 1936, a taxpayer is taken to have materially diminished risks of loss or opportunities for gain in respect of shares if the taxpayer's 'net position' (defined in former subsection 160APHJ(5) of the ITAA 1936) on a particular day in relation to the shares has less than 30% of those risks and opportunities.

138. The requirement to exclude any days on which the shareholder has materially diminished risks of loss or opportunities for gain in respect of shares is often referred to in positive terms as requiring the shareholder to only count the days during the relevant qualification period on which they hold the shares 'at risk'.

139. This Ruling is made on the basis that a Holder or an associate of a Holder has not made, is not under an obligation to make, or is not likely to make, a related payment in respect of any of the Dividends (see subparagraph 72(l) of this Ruling).

140. On the basis that the Holders have not made, nor are under an obligation to make, nor are likely to make, a related payment in respect of any of the Dividends, the relevant qualification period is the primary qualification period pursuant to former paragraph 160APHO(1)(a) of the ITAA 1936.

141. The former section 160APHD of the ITAA 1936 defines the 'primary qualification period' in relation to a taxpayer in relation to shares as:

... (b) if the shares are preference shares – the period beginning on the day after the day on which the taxpayer acquired the shares, and ending on the 90th day after the day on which the shares became *ex dividend*.

142. The former subsection 160APHE(1) of the ITAA 1936 defines '*ex dividend*' as:

A share in respect of which a dividend is to be paid... becomes *ex dividend* on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

143. The Holders will be capable of each being a 'qualified person' under the former paragraph 160APHO(1)(a) of the ITAA 1936, because this Ruling is made on the basis that (see subparagraphs 72(k) and (m) of this Ruling) that:

- neither a Holder nor an associate of a Holder has taken any positions (apart from holding the NAB CPS) in relation to their NAB CPS;
- the Holders in receipt of Dividends on the NAB CPS will have held their NAB CPS for a period of at least 90 days (excluding the day of acquisition and the day of disposal of their NAB CPS, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the NAB CPS), within the primary qualification period in relation to at least one of the Dividends, which period begins on the day after the day on which the Holder acquired their NAB CPS and ends on the 90th day after the day on which the NAB CPS became *ex dividend*.

144. If a Holder of the NAB CPS is not a 'qualified person' under the former paragraph 160APHO(1)(a) of the ITAA 1936, or other provisions such as former sections 160APHR or 160APHT of the ITAA 1936, the Holder will not be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936. Section 207-145 of the ITAA 1997 will create the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for the Holder in relation to payments of some or all of the Dividends.

145. The Commissioner has confirmed that no determination will be made under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Dividends paid by NAB to the Holders (see paragraphs 78 and 79 of this Ruling).

146. Finally, section 207-145 applies where a distribution is made as part of a dividend stripping operation. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to section 207-155, if the making of the distribution arose out of, or was made in the course of, a scheme that:

- was by way of, or in the nature of, dividend stripping; or
- had substantially the effect of a scheme by way of, or in the nature of, dividend stripping.

147. The Transaction Documents provide no indication that the offering of the NAB CPS and the associated payment of franked Dividends to the Holders constitute a dividend stripping arrangement.

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

Qualified person and the Resale facility

149. In determining whether a shareholder is a 'qualified person' in relation to a dividend paid on their shares, every 'position' (defined in former subsection 160APHJ(2) of the ITAA 1936) in relation to the shares are taken into account in calculating the 'net position' (defined in former subsection 160APHJ(5) of the ITAA 1936) in relation to the shares. The 'net position' determines whether a shareholder has materially diminished risks of loss or opportunities for gain on a particular day in respect of shares held by the shareholder (former section 160APHM of the ITAA 1936). Under former subsection 160APHJ(2) of the ITAA 1936, a 'position' in relation to shares is anything that has a delta in relation to the shares.

150. An embedded share option is a 'position' in relation to a share if it is exercisable by or against a party other than the issuer of the share (Taxation Determination TD 2007/29).

151. Under the Resale facility in clauses 10 and 11 of the CPS Terms, NAB may (subject to certain conditions) elect to require the Holders to sell all or some of their NAB CPS to one or more Nominated Purchasers. Until NAB appoints an entity as a Nominated Purchaser, that entity has no right or ability to call for the NAB CPS from the Holders.

152. NAB is also not required to elect to exercise the Resale facility. It follows that the Resale facility is an option that is held by NAB, the issuer of the NAB CPS, and not by a third party. Therefore, the Resale facility does not constitute a separate 'position' in relation to the NAB CPS under former subsection 160APHJ(2) of the ITAA 1936.

153. For the purpose of determining whether a Holder is a 'qualified person' in relation to the Dividends under Division 1A of former Part IIIAA of the ITAA 1936, the Resale facility, of itself, will not affect a Holder's risks of loss or opportunities for gain in respect of the NAB CPS.

Conversion of each NAB CPS – CGT implications

154. Under the CPS Terms, the NAB CPS will Convert subject to the satisfaction of the Mandatory Conversion Conditions, or may Convert earlier if NAB elects to do so following the occurrence of certain defined events and subject to the satisfaction of any relevant conditions.

155. If Conversion happens, each NAB CPS that is being Converted will Convert into one Ordinary Share on the Conversion Date, through a variation of the rights attached to the NAB CPS. The Holders will also receive an allotment of an additional number of Ordinary Shares for no additional consideration.

156. Each NAB CPS is a share that 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 shares do not constitute individual CGT assets as defined by section 108-5, but rather combine to make up one CGT asset, being the share (Taxation Ruling TR 94/30).

157. Under section 104-25, CGT event C2 happens if an entity's ownership of an intangible CGT asset (such as a share) ends by the asset, among other things:

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

158. The mere variation of the rights attached to the NAB CPS and the allotment of an additional number of Ordinary Shares does not result in a Holder's ownership of the NAB CPS ending by the NAB CPS being redeemed or cancelled for the purposes of paragraph 104-25(1)(a), nor does it result in a Holder's ownership of the NAB CPS ending by the NAB CPS being converted for the purposes of paragraph 104-25(1)(f). Therefore, CGT event C2 will not happen on the Conversion of each NAB CPS.

159. Under section 104-155, CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset that an entity owns, and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base. The receipt of money or other consideration in respect of the variation of the rights attached to a share may cause CGT event H2 to happen (paragraphs 46 – 48 of Taxation Ruling TR 94/30).

160. The Conversion of the NAB CPS includes the allotment of an additional number of Ordinary Shares. This will result in an adjustment to the cost base and reduced cost base of the converted NAB CPS under Subdivision 130-A (see below).

161. Therefore, CGT event H2 will not happen on the Conversion of each NAB CPS.

162. The relinquishment by the Holders of some of the rights attached to the NAB CPS is not a CGT event that happens to part of the CGT asset (which part is, under paragraph 108-5(2)(a), capable of being a CGT asset) comprised by each NAB CPS (see paragraphs 9 and 40 – 42 of Taxation Ruling TR 94/30).

163. No other CGT event in Division 104 will occur as a result of the Conversion of each NAB CPS.

NAB CPS that are Written Off – CGT implications

164. Under the CPS Terms, if the NAB CPS are Written Off, the NAB CPS will not Convert into Ordinary Shares, and the rights attached to the NAB CPS will be automatically varied (without the express approval of Holders).

165. As stated above in relation to the CGT implications of the Conversion of each NAB CPS, and for the reasons given there, the mere variation of the rights attached to the NAB CPS when the NAB CPS are Written Off will not cause CGT event C2 to happen.

166. Under section 104-155, CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset that an entity owns, and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

167. The variation of the rights attached to the NAB CPS when the NAB CPS are Written Off is an act, transaction or event that occurs in relation to the NAB CPS. As the variation of rights will not result in an adjustment to the cost base or reduced cost base of the NAB CPS, CGT event H2 will happen when the NAB CPS are Written Off.

168. A capital gain is made from CGT event H2 if the capital proceeds because of the CGT event are more than the incidental costs incurred that relate to the event. A capital loss is made if the capital proceeds are less than the incidental costs (subsection 104-155(3)).

169. Subsection 116-20(2) provides that the capital proceeds from CGT event H2 are the money or other consideration an entity received, or is entitled to receive, because of the act, transaction or event that is the subject of CGT event H2.

170. There will be no capital proceeds because of CGT event H2 happening as a result of the NAB CPS being Written Off. There will be no incidental costs incurred that relate to the NAB CPS being Written Off. Accordingly, a Holder will not make a capital gain or a capital loss from CGT event H2 happening when the NAB CPS are Written Off.

171. No other CGT event will happen when the NAB CPS are Written Off.

Cost base of the additional Ordinary Shares

172. Section 6BA of the ITAA 1936 and Subdivision 130-A of the ITAA 1997 will apply to apportion the first element of the cost base and reduced cost base of each NAB CPS over the converted NAB CPS (being one Ordinary Share in NAB) and any additional Ordinary Shares allotted by NAB as a result of the Conversion of the NAB CPS.

173. 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.

174. Pursuant to subsection 6BA(3) of the ITAA 1936, as the additional Ordinary Shares allotted by NAB (being the bonus shares for the purposes of section 6BA of the ITAA 1936) are issued to the Holders for no consideration, and are not a dividend or taken to be a dividend (see below), the issue price of the NAB CPS (being the original shares for the purposes of section 6BA of the ITAA 1936) will be apportioned over the converted NAB CPS (being one Ordinary Share in NAB) and any additional Ordinary Shares allotted by NAB as a result of the Conversion of the NAB CPS.

175. 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.

176. The operative rule is in section 130-20, which sets out what happens if an entity owns shares in a company (the original equities) and the company issues other shares (the bonus equities) to the entity in relation to the original equities.

177. Under item 1 of the table in subsection 130-20(3), as the additional Ordinary Shares (being the bonus equities for the purposes of Subdivision 130-A) are not a dividend nor taken to be a dividend, the first element of the cost base and reduced cost base of each NAB CPS (being the original equities for the purposes of Subdivision 130-A) will be apportioned over both the converted NAB CPS (being one Ordinary Share in NAB) and any additional Ordinary Shares allotted by NAB as a result of the Conversion of the NAB CPS.

Acquisition time of the additional Ordinary Shares

178. Under item 1 of the table in subsection 130-20(3), any additional Ordinary Shares acquired by a Holder as part of the Conversion of the NAB CPS will be taken to have been acquired at the time when the NAB CPS were originally acquired by the Holders, being 20 March 2013.

Allotment of the additional Ordinary Shares – dividend

179. 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 in money or other property, and any amount credited by a company to any of its shareholders as shareholders.

180. Although the additional Ordinary Shares allotted by NAB on the Conversion of the NAB CPS will constitute 'property' in the hands of the Holders, the allotment will not be a disposition of property within 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). As there is no disposition, there cannot be any distribution of property by NAB.

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

182. Accordingly, the allotment of any additional Ordinary Shares on the Conversion of the NAB CPS will not constitute a dividend within the meaning of subsection 6(1) of the ITAA 1936, or be taken to be a dividend under subsection 6BA(5) of the ITAA 1936.

The value of the additional Ordinary Shares – ordinary income

183. The allotment of the additional Ordinary Shares will be an issue of shares for which consideration is not payable. The allotment of the additional Ordinary Shares will result in a re-expression of a Holder's interest in the share capital of NAB. Accordingly, the value of any additional Ordinary Shares allotted on the Conversion of the NAB CPS will not be included as ordinary income in the assessable income of any of the Holders under subsection 6-5(1) (*Commissioner of Taxation v. McNeil* (2007) 229 CLR 656; 2007 ATC 4223; (2007) 64 ATR 431).

Section 45 of the ITAA 1936

184. 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 (but not all) 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%.

185. NAB has paid fully franked dividends on all of the interests in NAB that are capable of giving rise to frankable distributions for several years. NAB expects to pay fully franked dividends in the foreseeable future to all the holders of interests in NAB that are capable of giving rise to frankable distributions, including the Holders, to the extent of the franking credits in its franking account.

186. Furthermore, the CPS Terms of the NAB CPS do not allow NAB to issue Ordinary Shares to some or all of the Holders as an alternative to the payment of Dividends, nor will there be any link between the allotment of the additional Ordinary Shares and the timing of the payment of any Dividends by NAB. Thus, as there will be no minimally franked dividends, the fact that additional Ordinary Shares will only be allotted to the Holders on the Conversion of the NAB CPS, rather than all of the shareholders of NAB, will not trigger section 45.

187. Therefore, section 45 of the ITAA 1936 will not apply to treat the value of the additional Ordinary Shares allotted to the Holders on the Conversion of the NAB CPS as an unfranked dividend paid by NAB to the Holders.

Section 45A of the ITAA 1936

188. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the capital benefits than other shareholders, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends. If these conditions are satisfied, the Commissioner can make a determination that all or part of the capital benefit is to be treated as an unfranked dividend, so that it can be included in the assessable income of the advantaged shareholders.

189. The allotment of the additional Ordinary Shares to the Holders on the Conversion of the NAB CPS is the 'provision of a capital benefit' to the Holders (as defined in paragraph 45A(3)(a) of the ITAA 1936).

190. The allotment of the additional Ordinary Shares will be in effect a replacement of the Holders' interest in the share capital of NAB represented by the NAB CPS for ordinary shares in NAB. In the absence of any other factors, the circumstances of the scheme indicate that there will be no streaming of capital benefits to some shareholders.

191. Accordingly, it cannot be said that the Holders will derive a greater benefit from the capital benefits than other NAB shareholders. Therefore, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefit provided to the Holders when the additional Ordinary Shares are allotted to them on the Conversion of the NAB CPS. Therefore, no part of the value of the additional Ordinary Shares will be an unfranked dividend in the hands of the Holders.

Section 45B of the ITAA 1936

192. Section 45B of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends. If applicable, the Commissioner can make a determination that all or part of the capital benefit is to be treated as an unfranked dividend, so that it can be included in the assessable income of the relevant taxpayer.

193. Specifically, section 45B applies where:

- (I) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a));
- (II) under the scheme a taxpayer, who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and

- (III) 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 (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

194. The arrangement involving the issue of the NAB CPS, including the possible Conversion of the NAB CPS, constitutes a scheme for the purposes of section 45B of the ITAA 1936.

195. The allotment of the additional Ordinary Shares to the Holders on the Conversion of the NAB CPS means that this is a scheme under which the Holders are being provided with a capital benefit (as defined in paragraph 45B(5)(a) of the ITAA 1936) by NAB. Paragraph 45B(2)(a) is satisfied.

196. A taxpayer, who may or may not be the person provided with the capital benefit, must obtain a tax benefit under the scheme. Under subsection 45B(9) of the ITAA 1936, a relevant taxpayer obtains a tax benefit if:

- (a) an amount of tax payable; or
- (b) any other amount payable under the ITAA 1936 or the ITAA 1997,

by the relevant taxpayer would, apart from the operation of section 45B of the ITAA 1936,

- (c) be less than the amount that would have been payable; or
- (d) be payable at a later time than it would have been payable,

if the capital benefit had been an assessable dividend.

197. The relevant taxpayers are the Holders (who also happen to be the persons provided with the capital benefit). The allotment of the additional Ordinary Shares to the Holders on the Conversion of the NAB CPS will not lead to the Holders deriving assessable income or making a capital gain (see paragraphs 83-84 and 89-90). By contrast, an assessable dividend would be included in the assessable income of the Holders. Therefore, the Holders have generally obtained a tax benefit from the scheme. Paragraph 45B(2)(b) is satisfied.

198. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, it must be objectively concluded, having regard to the relevant circumstances of the scheme, that one or more of the persons that entered into or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose) of enabling the relevant taxpayers (the Holders) to obtain a tax benefit. The relevant circumstances of the scheme are listed in subsection 45B(8) of the ITAA 1936.

199. The allotment of the additional Ordinary Shares to the Holders on the Conversion of the NAB CPS will not be in satisfaction of, or an alternative to, the payment of Dividends. Rather, it is a product of the Conversion of the NAB CPS according to the CPS Terms. The quantum of each Holder's interest in the share capital of NAB will not change when a Holder is provided with the capital benefit in the form of the additional Ordinary Shares. Furthermore, NAB has paid fully franked dividends on all of the interests in NAB that are capable of giving rise to frankable distributions for several years, and expects to pay fully franked dividends in the foreseeable future to all the holders of interests in NAB that are capable of giving rise to frankable distributions, including the Holders, to the extent of the franking credits in its franking account.

200. Having regard to the relevant circumstances of the scheme in subsection 45B(8) of the ITAA 1936, and on the basis of the information surrounding the scheme, the Commissioner has concluded that none of the persons who entered into or carried out any part of the scheme did so for a more than incidental purpose of enabling the Holders to obtain a tax benefit.

201. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefit provided to the Holders when the additional Ordinary Shares are allotted to them on the Conversion of the NAB CPS. Therefore, no part of the value of the additional Ordinary Shares will be an unfranked dividend in the hands of the Holders.

Amendment of the CPS Terms to substitute an Approved NOHC

202. The CPS Terms provide for the possibility of an Approved NOHC becoming the ultimate holding company of NAB. If this occurs, NAB may give a notice to the Holders specifying the amendments that will be made to the CPS Terms so as to ensure that, upon the Conversion of the NAB CPS, ordinary shares in the Approved NOHC will be issued to the Holders instead of NAB Ordinary Shares.

203. Under section 104-155, CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset that an entity owns, and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

204. The amendment of the CPS Terms to effect the substitution of an Approved NOHC as the issuer of ordinary shares to the Holders on the Conversion of the NAB CPS would be an act, transaction or event that occurs in relation to the NAB CPS. As the amendment of the CPS Terms would not result in an adjustment to the cost base or reduced cost base of the NAB CPS, CGT event H2 will happen when the CPS Terms are amended.

205. A capital gain is made from CGT event H2 if the capital proceeds because of the CGT event are more than the incidental costs incurred that relate to the event. A capital loss is made if the capital proceeds are less than the incidental costs (subsection 104-155(3)).

206. Subsection 116-20(2) provides that the capital proceeds from CGT event H2 are the money or other consideration an entity received, or is entitled to receive, because of the act, transaction or event that is the subject of CGT event H2.

207. There will be no capital proceeds because of CGT event H2 happening as a result of the amendment of the CPS Terms. There will be no incidental costs incurred that relate to the amendment of the CPS Terms. Accordingly, a Holder will not make a capital gain or a capital loss from CGT event H2 happening on the amendment of the CPS Terms.

208. No other CGT event will happen because of the amendment of the CPS Terms.

Conversion of each NAB CPS and the issue of ordinary shares in an Approved NOHC – CGT implications

209. Under section 104-25, CGT event C2 happens if an entity's ownership of an intangible CGT asset (such as a share) that is a convertible interest ends by the asset being converted (paragraph 104-25(1)(f)). Each NAB CPS is a convertible interest (see below). If an Approved NOHC becomes the ultimate holding company of NAB, the Conversion of each NAB CPS and the issue of Approved NOHC ordinary shares to the Holders will result in the conversion of a convertible interest, causing CGT event C2 to happen. This is because, on the Conversion Date, the NAB CPS will be transferred by the Holders to the Approved NOHC, and ordinary shares in the Approved NOHC will be issued to the Holders.

210. Subdivision 130-C applies to the acquisition of shares by converting a convertible interest.

211. 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 item 4 refers to an interest issued by the company that will, or may, convert into an equity interest in the company or a connected entity of the company.

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

213. The 'connected entity' of an entity is defined in subsection 995-1(1) of the ITAA 1997 and includes an 'associate' of the entity being examined. 'Associate' is defined in subsection 995-1(1) of the ITAA 1997 to have the meaning given by section 318 of the ITAA 1936.

214. The NAB CPS is an interest that may convert into ordinary shares in the Approved NOHC by the NAB CPS being satisfied by the issue of the Approved NOHC ordinary shares. This Ruling is made on the basis that the Approved NOHC ordinary shares will be equity interests in the Approved NOHC pursuant to Division 974.

215. If an Approved NOHC is the ultimate holding company of NAB at the time of the Conversion of the NAB CPS, the Approved NOHC will be an 'associate' of NAB under section 318 of the ITAA 1936, and thus a connected entity of NAB.

216. Therefore, each NAB CPS is a convertible interest in NAB under paragraph (b) of item 4 of the table in subsection 974-75(1).

217. Accordingly, a capital gain or capital loss that a Holder makes from CGT event C2 happening from converting the convertible interest, where the Conversion of the NAB CPS involves the issue of Approved NOHC ordinary shares to the Holders, is disregarded under subsection 130-60(3).

218. If it transpires that the Approved NOHC ordinary shares are not equity interests in the Approved NOHC pursuant to Division 974, each NAB CPS will not be a convertible interest in NAB. As a result, subsection 130-60(3) would not apply to disregard the capital gain or capital loss that a Holder makes from CGT event C2 happening.

Cost base of the Approved NOHC ordinary shares

219. 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 issued to the Holders will be calculated as the cost base of their NAB CPS at the time of the Conversion divided by the number of Approved NOHC ordinary shares they receive for each NAB CPS.

Acquisition time of the Approved NOHC ordinary shares

220. Under subsection 130-60(2), the Holders will be taken to have acquired the Approved NOHC ordinary shares at the time of the Conversion of the NAB CPS. This means that when determining a Holder's eligibility to make a discount capital gain from a CGT event happening to the Approved NOHC ordinary shares, the 12 month period will start from the day after the acquisition date of the Approved NOHC ordinary shares (Taxation Determination TD 2002/10) and not from the acquisition date of the NAB CPS.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/30; TD 2002/10;

TR 2006/10; TD 2007/29

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

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