



Class Ruling

Income tax: Macquarie Group Limited – Macquarie Group Capital Notes

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

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

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

What this Ruling is about

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

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- Section 26BB of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Subsection 44(1) of the ITAA 1936;
 - Section 45 of the ITAA 1936;
 - Subsection 45A(2) of the ITAA 1936;
 - Paragraph 45B(3)(b) of the ITAA 1936;
 - Section 45C of the ITAA 1936;
 - Section 70B of the ITAA 1936;
 - Section 159GQ of the ITAA 1936;
 - Paragraph 177EA (5)(b) of the ITAA 1936;

- Section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Subdivision 130-C of the ITAA 1997;
- Subsection 130-60(1) of the ITAA 1997;
- Subsection 130-60(2) of the ITAA 1997;
- Subsection 130-60(3) of the ITAA 1997;
- Paragraph 204-30(3)(c) of the ITAA 1997;
- Subsection 207-20(1) of the ITAA 1997; and
- Section 207-145 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are investors (referred to as Holders) who acquired fully paid, unsecured, subordinated, mandatorily convertible notes issued by Macquarie Group Limited (MGL) called Macquarie Group Capital Notes (MCN) and who:

- hold the MCN on capital account;
- are Australian residents (within the meaning of subsection 6(1) of the ITAA 1936); and
- are not subject to the Taxation of Financial Arrangements rules in Division 230 of ITAA 1997 in relation to financial arrangements under the scheme.

(Note – Division 230 of the ITAA 1997 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 MCN who acquired their MCN otherwise than by initial application under the replacement Prospectus for the issue of MCN lodged with ASIC on 22 May 2013 (the Prospectus).

Qualifications

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

6. This Ruling does not consider the tax implications of Exchange of the MCN on the occurrence of a Non-Viability Event or an Acquisition Event.

7. This Ruling does not consider the tax implications of the Resale of the MCN under a Resale Notice.

8. This Ruling does not consider how the tax law applies to a Nominated Party who acquires their MCN under a Resale Notice.

9. This Ruling does not consider how the gross-up and tax offset rules in Division 207 of the ITAA 1997 apply to partnerships or trustee Holders, or to indirect distributions to partners in a partnership, or beneficiaries or trustees of a trust.

10. This ruling does not deal with how the tax law applies to MGL in relation to the issue of the MCN.

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

12. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 47 of this Ruling.

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

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

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Date of effect

15. This Ruling applies from 1 July 2012 to 30 June 2021. The Ruling continues to apply after 30 June 2021 to all entities within the specified class who entered into the specified scheme 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

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

- application for Class Ruling dated 22 May 2013;
- the Prospectus;
- the Terms and Conditions of MCN attached as Appendix A to the Prospectus (MCN Terms);
- the MCN Trust Deed dated 14 May 2013 (as amended and restated on 21 May 2013) (MCN Trust Deed);
- Constitution of MGL as at 30 August 2007;
- MGL Australian Securities Exchange (ASX) Announcement dated 3 May 2013;
- MGL announcement dated 14 May 2013 relating to its proposal to raise capital by issue of MCN; and
- further particulars provided by MGL.

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

17. In this Class Ruling, unless otherwise defined, capitalised terms take their meaning as specified in the MCN Terms.

18. MGL is the ultimate Non-Operating Holding Company (NOHC) of the Macquarie Group.

19. In the Prospectus, MGL announced its intention to undertake a capital raising by the issue of the MCN to raise \$580 million with the ability to raise more or less up to a maximum of \$600 million (the Offer). MGL will use the net proceeds of the Offer for general corporate funding and capital management purposes, including to facilitate the redemption of the Convertible Preferred Securities issued in July 2008 (2008 CPS).

20. On 13 May 2013 the Australian Prudential Regulatory Authority (APRA) confirmed that the proposed issue of MCN will qualify for inclusion as Eligible Capital of MGL, for the purposes of its prudential supervision of MGL as a NOHC (including under the forthcoming conglomerates framework), until the First Scheduled Optional Exchange Date, being 7 June 2018, of the MCN. However, there is no certainty that the MCN will be Exchanged, Redeemed or Resold at the First Scheduled Optional Exchange Date as APRA approval for Redemption or Resale may not be forthcoming, and in any event, MGL may be unwilling to Exchange, Redeem or Resell the MCN at this time. Accordingly, the MCN may remain on issue after the First Scheduled Optional Exchange Date, and may still be on issue on the Mandatory Exchange Date (at which time they would be Exchanged, subject to satisfaction of the Exchange Conditions).

21. The issue date for MCN is 7 June 2013. The MCN will be listed on the ASX and trade under the ASX code MQGPA.

22. The Prospectus states that persons wishing to invest in MCN may apply under one or more of the following offers:

- the Reinvestment Offer is available for Eligible 2008 CPS Holders;
- the Broker Firm Offer is available to Australian resident retail and high net worth clients of Syndicate Brokers; or
- the Securityholder Offer is available to Eligible Securityholders.

Main features of the MCN

23. MCN are constituted by the MCN Trust Deed.

24. Each MCN is issued fully paid for an issue price of \$100 (Issue Price).

25. Subject to certain conditions at certain times, each MCN may be Redeemed or Resold by MGL, with the prior written consent of APRA, or Exchanged for fully paid Ordinary Shares in accordance with the MCN Terms.

26. Exchange is defined in the MCN Terms as the allotment and issue of Ordinary Shares in respect of a MCN in accordance and subject to clause 8 of the MCN Terms.

27. The MCN cannot be Redeemed, Resold or Exchanged at the option of a Holder.

Distribution calculation

28. Subject to the MCN Terms, each MCN entitles the Holder to receive on each Distribution Payment Date a cash distribution for the

Distribution Period ending on that Distribution Payment Date (Distribution) calculated according to the following formula:

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

where:

Distribution Payment Date means, in respect of a MCN:

- (a) each 7 June and 7 December commencing on 7 December 2013 until (but not including) the date on which that MCN has been Redeemed or Exchanged in accordance with the MCN Terms; and
- (b) the Redemption Date or, subject to clause 7.6(c), the Resale Date or an Exchange Date, except where the Exchange is on account of a Non-Viability Event;

Distribution Rate means (Reference Rate + Margin) × Franking Adjustment Factor, where:

- (a) **Reference Rate** means, for a Distribution Period, the rate (expressed as a percentage per annum) which is the average mid-rate for Bills for a term of 180 days as displayed on the 'BBSW' page of the Reuters Monitor System (or any page that replaces that page) on the first Business Day of the Distribution Period.

However, if the average mid-rate is not displayed by 10.30am on that day, or if it is displayed but MGL determines that there is a manifest error in that rate, Reference Rate means the rate specified by MGL in good faith at or around 10.30am on that day, having regard, to the extent possible, to:

- (i) the rates otherwise bid and offered for Bills of a term of 180 days at or around that time on that day (including any displayed on the 'BBSW' page of the Reuters Monitor System (or any page that replaces that page)); and
 - (ii) if bid and offer rates for Bills of a term of 180 days are not otherwise available, the rates otherwise bid and offered for funds of a term of 180 days at or around that time on that day, (and provided that where a MCN is Resold on a day which is not a scheduled semi-annual Distribution Payment Date, the Reference Rate for the Distribution Period commencing on the Resale Date is the Reference Rate for the Distribution Period preceding the Resale Date);
- (b) **Bills** has the meaning it has in the *Bills of Exchange Act 1909* (Cth);

- (c) **Franking Adjustment Factor** means:

$$\frac{(1 - T)}{1 - [T \times (1 - F)]}$$

where:

- (i) **F** means the Franking Rate; and
 - (ii) **T** means the Tax Rate;
- (d) **Margin** means 4.00% per annum;
- N** means, in respect of a Distribution Period, the number of days in that Distribution Period.

29. Distributions on MCN are expected to be franked at the same rate that applies to MGL's Ordinary Shares, which is currently 40%. The level of franking on Distributions may vary over time in line with that on Ordinary Shares and may be nil.

Distribution payment conditions

30. The payment of any Distribution will be made unless:

- (a) MGL, in its absolute discretion, determines that the Distribution is not payable to Holders;
- (b) payment of the Distribution would result in MGL breaching APRA's capital adequacy requirements applicable to it;
- (c) payment of the Distribution would result in MGL becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*; or
- (d) APRA objects to the payment of the Distribution.

31. In determining not to pay a Distribution, MGL shall consider payment of Distributions as if it were payment of a dividend on a preference share which is an Equal Ranking Obligation.

32. Distributions are non-cumulative and interest is not payable by MGL on any unpaid Distributions. MGL has no liability to pay the unpaid amount of the Distribution and Holders have no claim or entitlement in respect of such non-payment.

33. A Dividend Restriction applies to MGL if MGL fails to pay a Distribution in full within 10 business days of the relevant Distribution Payment Date.

Scheduled Mandatory Exchange

34. Each MCN will mandatorily Exchange into Ordinary Shares on the date that is the earlier of (each a Mandatory Exchange Date):

- 7 June 2021 (Scheduled Mandatory Exchange Date) or
- any semi-annual Distribution Payment Date after the 7 June 2021 (a Deferred Mandatory Exchange Date),

on which the Exchange Conditions are satisfied, unless the MCN have been or will be Redeemed or Exchanged before that date.

35. Broadly, the Exchange Conditions are:

- the Daily Volume Weighted Average Price (VWAP) of Ordinary Shares on the 25th Business Day prior to the Relevant Mandatory Exchange Date is greater than 56% of the Issue Date VWAP (First Exchange Condition);
- the VWAP during the 20 ASX Trading Days prior to the Relevant Mandatory Exchange Date is such that the number of Ordinary Shares to be issued is less than or equal to the Maximum Exchange Number applicable to a Mandatory Exchange Date (Second Exchange Condition);
- no Suspension Event applies in respect of the Relevant Mandatory Exchange Date (Third Exchange Condition); and
- MGL is not Delisted as at the Relevant Mandatory Exchange Date (Fourth Exchange Condition).

Optional Exchange

36. MGL may, in its sole discretion, elect to Exchange all or some of the MCN:

- on any Scheduled Optional Exchange Date; and
- after the occurrence of a Tax Event or Regulatory Event.

37. The Scheduled Optional Exchange Dates are the Distribution Payment Dates falling on or about:

- (a) 7 June 2018 (the First Scheduled Optional Exchange Date);
- (b) 7 December 2018 (the Second Scheduled Optional Exchange Date); and
- (c) 7 June 2019 (the Third Scheduled Optional Exchange Date).

38. The Second, Third and Fourth Exchange Conditions, as described in paragraph 35, also apply to an Optional Exchange.

39. MCN may also be Exchanged upon the occurrence of a Non-Viability Event or an Acquisition Event.

General provisions applicable to Exchange

40. Broadly, on Exchange:

- Each Holder's rights in relation to each MCN that is being Exchanged will be immediately and irrevocably terminated for an amount equal to the Issue Price of that MCN and MGL will apply that Issue Price by way of payment for the subscription for the Ordinary Shares to be allotted and issued under clause 8.1 of the MCN Terms.
- Each Holder is taken to have irrevocably directed that any amount payable under clause 8.1 of the MCN Terms is to be applied as provided for in that clause and no Holder has any right to payment in any other way.
- If the total number of Ordinary Shares to be allotted to a Holder in respect of their aggregate holding of MCN upon Exchange includes a fraction of an Ordinary Share, that fraction of an Ordinary Share will be disregarded.

41. The Exchange Number is calculated in accordance with the formula set out in clause 8.1 of the MCN Terms subject to the Exchange Number being no greater than the Maximum Exchange Number.

Optional Redemption

42. MGL, in its sole discretion, but with APRA's prior written approval, may elect to Redeem all or some of the MCN on a Scheduled Optional Exchange Date, or Redeem all or some of the MCN following the occurrence of a Tax Event or a Regulatory Event by way of notice to the Holders of the MCN.

43. On the Redemption Date, the MCN being Redeemed will be done so by payment of the Issue Price to the Holder at the Redemption Date and Distributions from the immediately preceding Distribution Payment Date and up to (but excluding) the Redemption Date will be paid subject to the Distribution Payment Conditions, as described in paragraph 30 of this Ruling, being met.

44. Once the payment of the Redemption Price and Distributions have been paid, all other rights conferred and restrictions will no longer have effect and the MCN will be cancelled.

Resale

45. On any date on which it may issue a Redemption Notice, in lieu of such Redemption Notice, MGL may, at its sole discretion, but with APRA's prior written approval, issue to each Holder a notice (a Resale Notice) specifying that all or some of each Holder's holding of MCN will be transferred to one or more Nominated Parties (Resale).

46. Each Holder on the Resale Date is taken to irrevocably offer to sell the MCN that are subject of the Resale Notice to the Nominated Party or Nominated Parties for the purchase price per MCN equal to the Issue Price of that MCN.

Other Matters

47. The Ruling is made on the basis that:

- (a) The documents listed in paragraph 16 of this Ruling provide a complete and accurate description of the scheme, are intended by the parties to have their legal effect, and will be implemented according to their terms.
- (b) During the term of the scheme, MGL will be a resident of Australia under the income tax laws of Australia.
- (c) The MCN are 'equity interests' and 'convertible interests' in MGL for the purposes of Division 974 of the ITAA 1997.
- (d) The Ordinary Shares obtained by a Holder on the Exchange of the MCN will be 'equity interests' under Division 974 of the ITAA 1997.
- (e) Distributions paid in respect of the MCN are frankable distributions under section 202-40 of the ITAA 1997 and are not unfrankable under section 202-45 of the ITAA 1997.
- (f) MGL will frank Distributions in respect of the MCN in accordance with its franking policy that applies to Ordinary Shares (at such a time as Distributions are made) and satisfies the benchmark franking rule.
- (g) MGL will not differentially frank Distributions to different Holders in respect of the MCN according to the tax status of Holders or on any other basis.
- (h) Distributions in respect of the MCN will not be debited to MGL's share capital account (within the meaning of section 975-300 of the ITAA 1997) or non-share capital account (within the meaning of section 164-10 of the ITAA 1997).

- (i) Distributions for the MCN will be sourced from accounting income of MGL.
- (j) Immediately before payment of a Distribution on the MCN, MGL will have sufficient available profits worked out under section 215-20 of the ITAA 1997) to pay the Distribution.
- (k) The share capital of MGL will not become tainted (within the meaning of Division 197 of the ITAA 1997) by the issue of the MCN or Ordinary Shares on Exchange.
- (l) MGL's policies in relation to the franking of its Ordinary Shares dividends are not expected to change as a result of the issuance of the MCN.
- (m) On Exchange or Redemption of the MCN, MGL will debit the Issue Price of the MCN to its non-share capital account (within the meaning of section 164-10 of the ITAA 1997).
- (n) Holders, and their associates, will not have taken any positions (within the meaning of former section 160APHJ of the ITAA 1936) in relation to the MCN apart from the holding of the MCN themselves that would cause a Holder not to be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.
- (o) Holders, and their associates, will not make any related payments (within the meaning of former section 160APHN of the ITAA 1936) in relation to Distributions payable on the MCN.
- (p) Holders will not dispose of their MCN before a period of at least 90 days (excluding the date of acquisition and disposal) beginning the day after the acquisition of the MCN.
- (q) The accounts of the Macquarie group are prepared in accordance with applicable accounting standards.

Ruling

Inclusion of franking credits in assessable income

48. Holders must include in their assessable income an amount equal to the franking credits attached to the Distribution (subsection 207-20(1) of the ITAA 1997) unless Subdivision 207-D of the ITAA 1997 applies.

Imputation benefits – streaming of imputation benefits

Section 204-30 of the ITAA 1997

49. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received by a Holder in relation to Distributions paid in respect of MCN.

Section 177EA of the ITAA 1936

50. 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 Distributions paid in respect of MCN.

Gross-up and tax offset denied in certain circumstances

51. Section 207-145 of the ITAA 1997 will not apply to the whole, or any part, of the Distributions paid to Holders. Accordingly, section 207-145 will not adjust the Holders' assessable income to exclude the franking credit, nor will it deny the tax offset to which the Holders would have otherwise been entitled.

Each MCN will not be a traditional security

52. Section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of Holders upon disposal of their MCN.

53. Section 70B of the ITAA 1936 will not apply to allow a deduction to Holders upon disposal of their MCN.

Each MCN will not be a qualifying security

54. Section 159GQ of the ITAA 1936 will not apply to include Distributions in the assessable income of Holders on an accruals basis.

Exchange of the MCN – CGT implications

55. CGT event C2 (section 104-25 of the ITAA 1997) will happen for Holders on Exchange of the MCN for Ordinary Shares.

56. Any capital gain or capital loss made by a Holder from CGT event C2 happening on Exchange of the MCN will be disregarded (subsection 130-60(3) of the ITAA 1997).

Cost base and reduced cost base of Ordinary Shares acquired on Exchange

57. On Exchange of the MCN, Subdivision 130-C of the ITAA 1997 will apply so that the first element of the cost base and reduced cost base of the Ordinary Shares acquired on Exchange of a MCN will be the cost base of the MCN at the time of Exchange (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of Ordinary Shares on Exchange

58. Ordinary Shares acquired upon Exchange of the MCN (being convertible interests) will be taken to be acquired when the Exchange happens on the relevant Exchange Date (subsection 130-60(2) of the ITAA 1997).

Allotment of Ordinary Shares on Exchange not a dividend

59. The allotment of Ordinary Shares on Exchange of the MCN will not be included as a dividend in the assessable income of a Holder under subsection 44(1) of the ITAA 1936.

Section 45 of the ITAA 1936

60. Section 45 of the ITAA 1936 will not apply to treat the Ordinary Shares issued on Exchange to a Holder as an unfranked dividend paid by MGL.

Section 45A of the ITAA 1936

61. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or part of, a capital benefit that arises on Exchange or Redemption of the MCN as an unfranked dividend in the hands of Holders.

Section 45B of the ITAA 1936

62. 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 treat the whole, or part of, a capital benefit that arises on Exchange or Redemption of the MCN as an unfranked dividend in the hands of Holders.

Appendix 1 – Explanation

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

Inclusion of franking credits in assessable income

63. Paragraph 44(1)(a) of the ITAA 1936 provides that the assessable income of a resident shareholder in a company includes all dividends and non-share dividends paid to the shareholder by the company.

64. The MCN are equity interests under Division 974 of the ITAA 1997 and Holders are equity holders. Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which governs dividends) applies to an equity holder in the same way as it applies to a shareholder.

65. Distributions paid in respect of the MCN are non-share dividends under section 974-120 of the ITAA 1997. Accordingly, Holders must include in their assessable income Distributions paid in respect of the MCN under subparagraph 44(1)(a)(ii) of the ITAA 1936.

66. Distributions paid in respect of the MCN are expected to be franked. If a company makes a franked distribution to another entity, subsection 207-20(1) of the ITAA 1997 requires that the assessable income of the receiving entity include the amount of the franking credit on the distribution in addition to the amount of the franked distribution. Subsection 207-20(2) of the ITAA 1997 provides that the receiving entity is entitled to a tax offset equal to the franking credit on the distribution.

67. In accordance with subsection 207-20(1) of the ITAA 1997, any franking credit attached to a Distribution must also be included in the relevant Holder's assessable income for the income year in which the Distribution is made.

68. In accordance with subsection 207-20(2) of the ITAA 1997, Holders are entitled to receive a tax offset equal to the franking credit which has been included in their assessable income in respect of Distributions they receive.

69. If the Distribution is exempt income or non-assessable non-exempt income in the hands of the Holder and none of the exceptions in Subdivision 207-E of the ITAA 1997 apply, then the amount of any franking credit on the Distribution is not included in the assessable income of the Holder and the Holder is not entitled to a tax offset under Division 207 of the ITAA 1997 (Subdivision 207-D of the ITAA 1997).

Imputation benefits – streaming of imputation benefits***Section 204-30 of the ITAA 1997***

70. Subdivision 204-D of the ITAA 1997 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.

71. Section 204-30 of the ITAA 1997 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 of the ITAA 1997 applies where an entity 'streams' the payment of distributions in such a way that:

- an 'imputation benefit' is, or apart from section 204-30 of the ITAA 1997 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); 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) of the ITAA 1997).

72. Streaming is not defined for the purposes of Subdivision 204-D of the ITAA 1997. 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 imputation credits' (paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002).

73. MGL has indicated that all Holders will receive franked Distributions regardless of their tax attributes or their individual tax position. MGL's policy in relation to the franking of its frankable distributions is not expected to change as a result of the issue of the MCN.

74. The Ordinary Shares allotted on Exchange of the MCN will not attract the application of section 204-30 of the ITAA 1997. This is because the issue of Ordinary Shares does not constitute a distribution, and the allotment of Ordinary Shares will not affect MGL's dividend franking policy.

75. Based on the information provided, the Commissioner has concluded that the requisite element of streaming does not exist in relation to the franked Distributions to be paid by MGL to Holders. Accordingly, the Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received by a Holder in relation to Distributions paid in respect of the MCN.

Section 177EA of the ITAA 1936

76. 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.

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

- there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- 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
 - the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
 - 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
 - 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.

78. Subsection 177EA(12) of the ITAA 1936 extends the operation of section 177EA to non-share equity interests. Subsection 177EA(12) provides that section 177EA:

- applies to a non-share equity interest in the same way as it applies to a membership interest;
- applies to an equity holder in the same way as it applies to a member; and
- applies to a non-share dividend in the same way as it applies to a distribution.

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

- (a) the issue of the MCN 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. Pursuant to paragraph 177EA(12)(a) of the ITAA 1936, section 177EA applies to a non-share equity interest in the same way as it applies to a membership interest. Therefore, as the MCN are non-share equity interests, paragraph 177EA(3)(a) of the ITAA 1936 is satisfied;
- (b) frankable distributions are expected to be payable to the Holders (paragraph 177EA(3)(b) of the ITAA 1936). The Commissioner accepts that Distributions payable on the MCN will be frankable distributions to the extent that the Distributions on the MCN do not fall within the list of relevant factors in section 202-45 of the ITAA 1997;
- (c) franked Distributions are expected to be paid to the Holders (paragraph 177EA(3)(c) of the ITAA 1936). It is expected that the Distributions will be made semi-annually. Furthermore, MGL has advised that MGL's policies in relation to the franking of its Ordinary Share dividends are not expected to change as a result of the issuance of the MCN; 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 Holders, given that MGL expects to frank the Distributions on the MCN (paragraph 177EA(3)(d) of ITAA 1936).

80. 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 (Holder of MCN) to obtain an imputation benefit.

81. 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.

82. 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.

83. 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 MGL's purpose of raising Eligible Capital.

84. 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 received by Holders in relation to Distributions paid in respect of the MCN.

Gross-up and tax offset denied in certain circumstances

85. Subdivision 207-F of the ITAA 1997 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.

86. Section 207-145 of the ITAA 1997 provides the circumstances that must exist before this adjustment can occur. Pursuant to subsection 207-145(1) of the ITAA 1997 a 'manipulation of the imputation system' may 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 IIIAA 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); or
- the distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d) of the ITAA 1997).

87. A person is 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 (see former section 160APHO of the ITAA 1936).

88. By virtue of former section 160AOA of the ITAA 1936, the holding period rule and the related payments rule apply to non-share equity interests, equity holders and non-share dividends in the same way as they apply to shares, shareholders and dividends respectively.

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

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

91. A Holder will be a 'qualified person' in relation to a Distribution received in respect of their MCN, provided that:

- the Holder held their MCN 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 Holder acquired the MCN and ending on the 90th day after the day on which the MCN became ex-dividend (former subsections 160APHO(2) and 160APHO(3) of the ITAA 1936 and former sections 160APHM and 160APHJ of the ITAA 1936); and

- neither the Holder, nor an associate of the Holder, has made, is under an obligation to make, or are likely to make a related payment in relation to Distributions on their MCN (former paragraph 160APHO(1)(a) of the ITAA 1936 and former section 160APHN of the ITAA 1936).

92. In determining whether a shareholder is a 'qualified person' in relation to dividends paid on their shares, all 'positions' in respect of the shares are taken into account in identifying a 'net position' to ensure that there is no material diminution in the risks of loss or opportunities for gain.

93. The Commissioner has concluded that the Resale and Exchange mechanisms in relation to the MCN will not of themselves affect a Holder's risks of loss or opportunities for gain in respect of the MCN.

94. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Distributions paid to Holders in respect of the MCN.

95. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to paragraph 207-145(1)(d) of the ITAA 1997, where the distribution arose out of, or was made in the course of, a scheme or substantially similar arrangement that was in the nature of dividend stripping.

96. The Prospectus and MCN Terms provide no indication that the offering of the MCN and the associated payment of franked Distributions to Holders in any way constitutes a dividend stripping arrangement.

Each MCN will not be a traditional security

97. A traditional security is defined in subsection 26BB(1) of the ITAA 1936 as a security held by the taxpayer that was acquired by the taxpayer after 10 May 1989, is not a prescribed security within the meaning of section 26C of the ITAA 1936, is not trading stock of the taxpayer, and either does not have an eligible return, or has an eligible return that satisfies the conditions listed in subparagraph (b)(ii) of the definition of traditional security in subsection 26BB(1) of the ITAA 1936.

98. The term 'security' is defined in subsection 26BB(1) of the ITAA 1936 by reference to subsection 159GP(1) of the ITAA 1936. Pursuant to subsection 159GP(1), 'security' means:

- (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
- (b) a deposit with a bank or other financial institution;
- (c) a secured or unsecured loan; or

- (d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

99. The MCN is not a stock, bond, debenture, certificate of entitlement, bill of exchange, or a promissory note.

100. The term 'or other security' in paragraph (a) of the definition of security only encompasses instruments that evidence an obligation on the part of the issuer or drawer to pay an amount to the holder or acceptor, whether during the term of the instrument or at its maturity. The types of securities referred to in paragraph (a) of the definition of security will generally be recognised as debt instruments (Taxation Ruling TR 96/14).

101. Paragraphs (b) and (c) of the definition of security do not apply because the MCN is neither a deposit with a bank or other financial institution, nor a secured or unsecured loan.

102. Only those contracts that have debt like obligations will usually fall under paragraph (d) of the definition of security (TR 96/14).

103. The MCN Terms do not evidence a liability by MGL to pay an amount or amounts to Holders of the MCN during the term of the instrument or at maturity.

104. The MCN are perpetual and Holders do not have a right to require Exchange, Resale or Redemption.

105. The payment by MGL of Distributions is subject to the Distribution Payment Conditions. Distributions are discretionary and non-cumulative. If a Distribution is not paid, MGL has no liability to pay the Distribution and Holders have no claim in respect of non-payment.

106. Upon Exchange, MGL will allot and issue a number of Ordinary Shares based on a formula set out in the MCN Terms for each MCN held by the Holder. Each Holder's rights in relation to each MCN that is being Exchanged are immediately and irrevocably terminated for an amount equal to the Issue Price and MGL will apply that amount by way of payment for the subscription for Ordinary Shares issued to Holders. MGL cannot be said to have a liability to pay an amount under the MCN Terms pursuant to the Exchange.

107. Redemption of the MCN is possible. However, it is at the option of MGL and requires the prior written approval of APRA. This does not establish a liability on MGL to pay an amount.

108. MGL will not become liable to pay an amount under the MCN upon a wind-up as it would be expected that, before a wind-up commences, the MCN would either be Exchanged into Ordinary Shares pursuant to a Non-Viability Event (in which case any distribution would be made to the Holders as ordinary shareholders as opposed to under the MCN Terms), or Holders' rights would be terminated where MGL is not able to issue Ordinary Shares within the time stated in the MCN Terms.

109. As the MCN is not a security within the meaning of subsection 159GP(1) of the ITAA 1936, it cannot be a traditional security under subsection 26BB of the ITAA 1936.

110. Accordingly, section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of the Holder upon disposal of the MCN.

111. Section 70B of the ITAA 1936 will also not apply to allow a deduction to Holders upon disposal of their MCN.

Each MCN will not be a qualifying security

112. Under Division 16E of Part III of the ITAA 1936 (Division 16E of the ITAA 1936), the income and deductions from qualifying securities are spread over the term of the security on a basis which reflects the economic gains and losses which have accrued at any point in time (section 159GQ of the ITAA 1936).

113. A qualifying security is defined in subsection 159GP(1) of Division 16E of the ITAA 1936 and must, among other requirements, be a security. As stated in the Ruling at paragraph 109, the MCN are not a 'security' within the meaning of subsection 159GP(1). Therefore, the MCN is not a qualifying security for the purposes of Division 16E.

Exchange of the MCN – CGT implications

114. CGT event C2 (section 104-25 of the ITAA 1997) will happen to Holders on Exchange of the MCN for Ordinary Shares.

115. Under paragraph 104-25(1)(f) of the ITAA 1997, CGT event C2 happens if an entity's ownership of an intangible CGT asset ends by the asset (if it is a convertible interest) being converted.

116. MCN are convertible interests. The Exchange of MCN for Ordinary Shares constitutes the conversion of a convertible interest.

117. The Exchange of MCN happens as part of a conversion to which Subdivision 130-C of the ITAA 1997 applies. Under subsection 130-60(3) of the ITAA 1997, a capital gain or capital loss made from converting a convertible interest is disregarded. Any capital gain or capital loss made by a Holder from CGT event C2 happening on Exchange of MCN will be disregarded.

Cost base and reduced cost base of Ordinary Shares acquired on Exchange

118. On Exchange of the MCN, Subdivision 130-C of the ITAA 1997 will apply so that the first element of the cost base and reduced cost base of the Ordinary Share acquired on Exchange will be the cost base of the MCN at the time of Exchange (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of Ordinary Shares on Exchange

119. Ordinary Shares acquired upon Exchange of the MCN (being convertible interests) will be taken to be acquired when the Exchange happens on the relevant Exchange Date (subsection 130-60(2) of the ITAA 1997).

Allotment of Ordinary Shares on Exchange not a dividend

120. The issue of Ordinary Shares to Holders on Exchange is a distribution of property to holders of a non-share equity interest and a non-share distribution under subparagraph 974-115(b)(ii) of the ITAA 1997. A non-share distribution is a non-share dividend under subsection 974-120(1) of the ITAA 1997.

121. Subsection 974-120(2) of the ITAA 1997 provides that a non-share distribution is not a non-share dividend to the extent to which the company debits the distribution against the company's share capital account or non-share capital account.

122. On Exchange, MGL will debit the Issue Price of MCN to its non-share capital account. Accordingly, the issue of Ordinary Shares on Exchange is not a non-share dividend and will not be included in the assessable income of Holders under subparagraph 44(1)(a)(ii) of the ITAA 1936.

Section 45 of the ITAA 1936

123. 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 franked to less than 10%.

124. MGL expects to pay franked dividends/distributions to all its shareholders and non-share equity holders consistently. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to treat the issue of Ordinary Shares on Exchange as an unfranked dividend in the hands of Holders.

Section 45A of the ITAA 1936

125. Section 45A of the ITAA 1936 applies in circumstances where a company streams the provision of capital benefits 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).

126. The Commissioner may make a determination under subsection 45(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

127. A provision of capital benefits includes the provision to the shareholder of shares in the company pursuant to paragraph 45A(3)(a) of the ITAA 1936. The issue of Ordinary Shares to Holders on Exchange of MCN will constitute the provision of capital benefits.

128. The issue of Ordinary Shares on Exchange of MCN is in effect a restatement of the Holder's interest in the capital of MGL. In the absence of any other factors that would contribute to an alternative conclusion, there will not be any streaming of capital benefits.

129. An Optional Redemption will involve the provision of capital benefits within the meaning of subsection 45A(3) of the ITAA 1936 as it will constitute a non-share capital return (subsection 45A(3A) of the ITAA 1936). The amount paid to Holders on Optional Redemption is limited to the amount of the Issue Price of MCN and any Distribution entitlements on MCN will be paid to the extent the Distribution Payment Conditions under the MCN Terms are met.

130. Accordingly, it cannot be said that Holders would derive a greater benefit from capital benefits than other MGL shareholders. Therefore, an Optional Redemption or the issue of Ordinary Shares on Exchange will not trigger the application of section 45A of the ITAA 1936.

131. Accordingly the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936.

Section 45B of the ITAA 1936

132. Section 45B of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends and the conditions in subsection 45B(2) of the ITAA 1936 are met.

133. The Commissioner may make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

134. The issue of Ordinary Shares to Holders on Exchange will constitute a scheme under which the Holders are provided with a capital benefit by MGL (paragraph 45B(5)(a) of the ITAA 1936). Similarly, an Optional Redemption will also constitute a scheme under which the Holders are provided with a capital benefit by MGL (paragraph 45B(5)(b) and subsection 45B(7) of the ITAA 1936).

135. For the provision to apply, among other things, 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. A non-exhaustive list of relevant circumstances of the scheme are provided in subsection 45B(8) of the ITAA 1936.

136. Having regard to the relevant circumstances surrounding the issue of MCN, it cannot be concluded that MGL, the Holders or any other person entered into or carried out the issue of MCN for the purpose of enabling Holders to obtain a capital benefit.

137. Similarly, it cannot be said that Optional Redemption will involve any benefit provided to Holders that is in substitution for Distributions. The amount paid to Holders on Optional Redemption is limited to an amount equal to the Issue price of MCN and any Distribution entitlements on MCN will be separately paid as a Distribution given that a Redemption Date will also be a Distribution Payment Date under the MCN Terms.

138. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/14; TR 2006/10

Subject references:

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- Anti-avoidance measures
- Capital gains tax
- CGT cost base
- Convertible interests
- Dividend imputation
- Franking tax offset
- Imputation benefits
- Qualified persons
- Streaming of imputation benefit
- Securities
- Traditional securities

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ATOlaw topic: Income Tax ~~ Assessable income ~~ dividend, interest and royalty income
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