TAXATION RULING NO. IT 2334

INCOME TAX : CONVERTIBLE NOTES - MEANING OF CONVERTIBLE NOTE, NOTE AND RELATED INSTRUMENTS

F.O.I. EMBARGO: May be released

REF H.O. REF: 86/231-2 DATE OF EFFECT:

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1209639	CONVERTIBLE NOTES	82L DIV 3A

PREAMBLE Advice was sought from this Office whether the provisions of Division 3A, Part III of the Income Tax Assessment Act applied to a proposed financing arrangement involving the contemporaneous issue of Eurobonds and share options. The essential matter for decision was whether the two instruments, i.e. the Eurobonds and the share options would, either individually or read together, constitute a convertible note for the purposes of Division 3A.

FACTS 2. The arrangements provided for the issue of bonds with an aggregate face value of Swiss Francs 300,000,000 bearing interest at the rate of 4 7/8% p.a. They were due to mature in 1998, twelve years after the date of issue. Early redemption was possible only where force majeure events occurred. The bonds were to be issued by a specialist finance subsidiary within a large company group. The payment of interest and repayment of principal would be guaranteed by the holding company.

3. Subscribers to the bonds would also receive warrants entitling them to subscribe for shares in the holding company. The warrants, which in effect were share options, could be exercised at any time during a period commencing approximately one month from the date of issue of the bonds and expiring 5 years later. The consideration to be paid upon exercise of the option would be an amount equal to the market price of the holding company's shares at the time of issue plus a small premium. The warrants would be non-interest bearing and would be listed on stock exchanges.

4. The bonds and the warrants would be issued under the same instrument. The warrant would be detachable from the bond by means of a perforation. The right of the warrant holder to subscribe for shares in the holding company was not contingent upon the warrant holder simultaneously being a bond holder. The finance company's obligations in respect of the warrants cease once the instrument is issued. In respect of the bonds however, the finance company would continue to be liable for the payment

of interest and repayment of principal for the term of the bond.

RULING 5. Advice was given that neither the bonds nor the warrants, alone or in combination, were considered to be convertible notes within the meaning of sub-section 82L(1).

6. "Convertible note" is defined in sub-section 82L(1). The definition is dependent upon ancillary definitions of the terms "loan" and "note". "Loan" is defined to include the various forms of a company's indebtedness while "note" means "a note or other instrument issued by a company that evidences, acknowledges, creates or relates to a loan to the company". The definitions carry over into the definition of "convertible note" which, for present purposes means a note (evidencing etc. a loan - a form of indebtedness) issued by a company that provides that the holder or owner is to or may have a right or option to have allotted etc shares in the capital of the company or some other company.

7. The bonds, standing alone, evidence a loan. They are not convertible notes of themselves. The bonds do not provide the holders or owners with a right or option to have shares allotted, etc to them. The warrants, standing alone, do not evidence, acknowledge create or relate to a loan to the issuing or holding company. The exercise of the option therein and the resultant issue of shares in the holding company do not in any way relinquish or reduce the issuing company's indebtedness.

8. Sub-section 82L(2) provides that, where the combined effect or operation of 2 or more related instruments, whether issued at the same time or not, would have the effect or operation of a convertible note, the instruments shall be deemed to be together a convertible note. As may be imagined, sub-section 82L(2) is a safeguarding measure designed to protect the operation of Division 3A against manipulation in this particular fashion. Sub-section 82L(2) will operate where a combination of documents reveals that a loan may be satisfied in whole or in part by the issue of shares in the borrower.

9. In the present case the bonds and warrants when read together cannot be construed as relieving the company, in whole or part, of its obligations to pay interest and re-pay capital by the issue of shares. Whether options under the warrants are exercised or not or whether by subscribers to the bonds or subsequent holders/owners of the warrants the company's indebtedness to the bond holders still stands. The bonds and warrants are not considered to be related in the sense for which sub-section 82L(2) exists.

COMMISSIONER OF TAXATION
30 June 1986

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