


# ***CR 2008/26 - Income tax: capital gains: Converting Preference Shares: St. George Bank Limited***

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## Class Ruling

### Income tax: capital gains: Converting Preference Shares: St. George Bank Limited

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

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

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

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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

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

#### **Relevant provision(s)**

2. The relevant provisions dealt with in this Ruling are:
- section 6BA of the *Income Tax Assessment Act 1936* (ITAA 1936);
  - subsection 44(1) of the ITAA 1936;
  - section 177EA 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 104-155 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;
- section 130-20 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- Division 207 of the ITAA 1997;
- section 207-20 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 the Australian resident investors (referred to as 'Holders') who subscribed for and were allotted St. George Bank Limited (St. George) Converting Preference Shares (CPS II) and who hold the CPS II on capital account.

4. The class of entities to which this Ruling applies does not extend to investors in the CPS II who acquired them otherwise than by initial subscription.

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

6. This Ruling does not consider how the taxation law applies to Third Party Purchasers who acquire CPS II under a Transfer Notice or Early Transfer Notice.

7. This Ruling does not consider the tax implications of the exchange of CPS II by redemption, cancellation or buy-back.

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

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

## **Qualifications**

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

11. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 19 to 58 of this Ruling.

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

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

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## **Date of effect**

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14. This Ruling applies from 28 December 2007 to 30 June 2014. However, the Ruling continues to apply after 30 June 2014 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

15. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

16. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

17. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

18. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

## Scheme

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

- the application for a Class Ruling (and appendices) dated 21 September 2007 lodged by Greenwoods & Freehills Pty Limited on behalf of St. George;
- the St. George Converting Preference Shares Prospectus dated 19 November 2007 (the CPS II Prospectus) lodged with the Australian Securities and Investments Commission (ASIC) on that date;
- the Terms of Issue contained in Annexure A of the CPS II Prospectus (the Terms); and
- correspondence (including emails) from Greenwoods & Freehills Pty Limited providing further information.

**Note:** certain information which relates to the affairs of St. George that is not in the public domain has been taken into account in determining the Commissioner's opinion set out in this Ruling (including the application of certain anti-avoidance provisions). This information has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

20. On 28 December 2007 St. George allotted 4 million CPS II. The CPS II were issued pursuant to the CPS II Prospectus. The CPS II were issued as fully paid at \$100 face value for each CPS II. The issue raised \$400 million.

21. The CPS II offer was available to:

- Eligible Securityholders (Holders of St George ordinary shares, Holders of St George Converting Preference Shares (CPS), St George non-cumulative unsecured preference shares (SPS), St George non-cumulative unsecured redeemable and convertible preference shares (SAINTS), with a registered address in Australia at 7pm on 16 November 2007);
- Australian residential retail clients, Co-Managers or Participating Brokers; and
- Institutional Investors who were invited by the Joint Lead Managers to bid for CPS II through the Bookbuild under the Institutional Offer.

22. There was no general public offer of CPS II.
23. The CPS II are listed on the Australian Securities Exchange (ASX) under the ASX code SGBPE.
24. St. George is subject to regulation by the Australian Prudential Regulation Authority (APRA). APRA requires Authorised Deposit-taking Institutions (ADI's) to maintain specified minimum ratios of total capital to risk-weighted assets. For this purpose, APRA issues Prudential Standards and Guidance Notes (Standards).
25. A bank's minimum capital requirements must be met at two levels. These two levels are known as Tier 1 and Tier 2 capital and have different requirements in terms of what instruments qualify as capital for APRA purposes under each of these tiers.
26. Tier 1 Capital is comprised of Fundamental Tier 1 Capital (such as ordinary shares) and Residual Tier 1 Capital (which includes Non-innovative Tier 1 Capital and Innovative Tier 1 Capital).
27. From 1 January 2008, there is a further restriction on the composition of the Residual Tier 1 Capital that will count as Tier 1 Capital. From this date, APRA Standards impose a maximum limit on the amount of Innovative Tier 1 Capital that will qualify for Tier 1 Capital status.
28. St. George is required to maintain a Tier 1 capital ratio of 7% and total capital ratio of 10%. The capital management policy of St. George targets a Tier 1 capital ratio in the range of 7.0% to 7.5%.
29. St. George redeemed its USD 250M Depository Capital Securities in June 2007. Following the redemption, the St. George group Tier 1 capital adequacy ratio reduced to approximately 6.7% on a pro-forma basis to the ratios presented as at 31 March 2007.
30. The capital management initiatives to be undertaken by St. George in 2007-2008 including an institutional placement of St. George ordinary shares, and the issue of the CPS II should result in an increase in St. George's pro-forma Tier 1 capital ratio to approximately 7.7% and therefore within St. George's target Tier 1 capital range.
31. APRA has classified the CPS II as 'Non-innovative Residual Tier 1 Capital' pursuant to the Standards.
32. St. George advise that proceeds of the CPS II issue will be used to fund the ongoing growth of St. George's business.

**CPS II Prospectus dated 19 November 2007 and Terms**

33. The CPS II are non-cumulative unsecured converting preference shares in the capital of St. George. The Holders of CPS II are entitled to receive a preferred non-cumulative floating rate dividend payable quarterly in arrears.

***Dividend calculation***

34. The Holder of each CPS II is entitled to receive a dividend (Dividend) payable in arrears (starting 20 February 2008) calculated using the following formula:

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

where:

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

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

where:

- **Bank Bill Swap Rate** (expressed as a percentage per annum) means, for each Dividend Period, the Bank Bill Swap Rate applying on the first Business Day of each Dividend Period;
- **Margin** (expressed as a percentage per annum) is 1.60% per annum as determined under the Bookbuild;
- **Tax Rate** (expressed as a decimal) means the Australian corporate tax rate applicable on the Issue Date, which will be taken to be 0.30; and

**N** is the number of days in the **Dividend Period** ending on (but not including) the relevant **Dividend Payment Date**.

35. St. George expects the Dividends to be fully franked. If the Dividend is unfranked or partially franked, the Dividend will be increased to compensate for the unfranked component, as determined by the calculation in clause 2.2 of the Terms. In addition, if the Australian corporate tax rate applicable to the franking account of St. George from which the Dividend will be franked differs from the Tax Rate, the Dividend will also be adjusted downwards or upwards accordingly.

***Dividend payment conditions***

36. The payment of a Dividend or any optional dividend (Optional Dividend), is, among other things, subject to the following conditions:

- the Directors of St. George (Directors), at their sole discretion, declaring the Dividend or Optional Dividend to be payable;
- St. George having profits available for the payment of a Dividend or an Optional Dividend;

- such payment not resulting in the Total Capital Ratio or the Tier 1 Capital Ratio of St. George (on a Level 1 basis), or, St. George and its controlled entities (on a Level 2 basis), not complying with APRA's then current capital adequacy guidelines as they are applied to St. George, or, St. George and its controlled entities (as the case may be) at the time, unless APRA otherwise gives its prior written approval;
- the amount of the Dividend or Optional Dividend being the lesser of the after tax profit of St. George, or, St. George and its controlled entities, calculated before any dividend or interest payments on certain Capital Securities generally, unless APRA otherwise gives its prior approval;
- the payment, in the opinion of the Directors, would not result in St. George becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*; and
- in the case of an Optional Dividend, APRA's prior written approval.

37. The Dividends are non-cumulative and the Holders will not have any recourse in the event of non-payment. Accordingly, non-payment of all or part of a declared Dividend does not constitute an event of default by St. George, and Holders have no claim in respect of such non-payment.

38. The Holders of the CPS II are also not entitled to any interest on unpaid Dividends or Optional Dividends.

39. A Dividend or Optional Dividend is only payable to those persons registered as Holders on the Record Date for that Dividend or Optional Dividend respectively.

### ***CPS II Conversion into Ordinary Shares***

40. St. George must Convert all CPS II on issue into Ordinary Shares on the Mandatory Conversion Date (refer to paragraph 43 of this Ruling for the meaning of Convert for the purposes of this Ruling).

41. The Mandatory Conversion Date will be the earlier of 20 August 2013 and the first Dividend Payment Date thereafter where both of the Mandatory Conversion Conditions are satisfied.

42. The Mandatory Conversion Conditions are:

- on the 25th Business Day before a possible Mandatory Conversion Date the VWAP (as defined in clause 9 of the Terms) of St. George Ordinary Shares (adjusted for the Conversion Discount) must be at least 55% of the Issue Price; and

- over the 20 Business Days before a possible Mandatory Conversion Date, the VWAP of Ordinary Shares (adjusted for the Conversion Discount) must be at least 50% of the Issue Share Price.

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

44. Each Holder may also be allotted an additional number of fully paid Ordinary Shares for each CPS II Converted in accordance with the relevant formula set out in clause 3.5 of the Terms, and as adjusted by clause 3.6 to clause 3.11 of the Terms. The formula incorporates a Conversion Discount of 1%.

45. The total market value of the Ordinary Shares held by a Holder immediately after the Conversion of the CPS II will be \$101.01.

46. Clause 3.4 of the Terms states that Conversion does not constitute redemption, buy-back or cancellation of a CPS II or an issue, allotment or creation of a new share (other than any additional Ordinary Shares allotted).

### ***Exchange Notice***

47. Subject to APRA's prior written approval, St. George must serve an Exchange Notice following the occurrence of an Acquisition Event. St. George may, subject also to APRA's prior written approval, serve an Exchange Notice following the occurrence of a Regulatory Event or a Tax Event.

48. An Exchange Notice gives St. George the right in respect of all (but not some only) of the CPS II to do any one or combination of the following:

- convert the CPS II into fully paid Ordinary Shares;
- redeem the CPS II for an amount equal to the face value by way of a cash payment;
- buy-back the CPS II for an amount equal to the face value by way of a cash payment; and/or
- cancel the CPS II for an amount equal to the face value by way of a cash payment.

49. St. George must serve an Exchange Notice, no later than the latest to occur of the following two events:

- five Business Days after APRA has given its written approval to the application of the mechanisms in clause 3.2(c) of the Terms; and
- six months after the occurrence of an Acquisition Event.

50. An Exchange Notice given by St. George is irrevocable.

51. Broadly, an Acquisition Event will occur when a takeover bid is made to acquire all or some St. George Ordinary Shares and the offer is or becomes unconditional, or where the Directors issue a statement recommending a scheme of arrangement.

52. A Regulatory Event will broadly occur as a result of any development in respect of securities laws of Australia generally that the Directors at their sole discretion determine to be unacceptable, or where the Directors determine that St. George is not or will not be entitled to treat all CPS II as eligible Tier 1 Capital.

53. A Tax Event will broadly occur as a result of any development in respect of taxation generally that has more than an insubstantial risk to:

- increase the cost of the CPS II as a result of St. George's exposure to increased taxes, duties or other governmental charges or civil liabilities;
- result in the CPS II not being treated as equity interests for taxation purposes;
- result in imputation benefits being denied to Holders in respect of the CPS II being on issue or the Ordinary Shares being on issue following any Conversion of CPS II into Ordinary Shares; or
- result in franking debits being posted to St. George's franking account in respect of the CPS II being on issue or the Ordinary Shares being on issue following any Conversion of CPS II into Ordinary Shares.

### ***Third Party Purchase***

54. St. George may elect that all CPS II on issue be acquired from Holders by one or more Third Party Purchaser(s) on a Relevant Date or an Exchange Date. The Third Party Purchaser(s) will be an entity nominated by St. George. St. George will make the election by serving a Transfer Notice or Early Transfer Notice to CPS II Holders within the time periods stipulated in Clauses 4.2 and 4.3 of the Terms. The Third Party Purchaser(s) will acquire the CPS II from the Holders for cash equal to the face value of the CPS II acquired.

***General rights attaching to CPS II***

55. CPS II are not deposit liabilities of St. George. CPS II rank equally among themselves and are unsecured and subordinated to all depositors and creditors of St. George. Furthermore, CPS II rank equally with all other Equal Ranking Capital Securities in respect of the payment of Dividends that have been declared and in respect of the payment of dividends or other distributions that have been declared or are payable on all other Equal Ranking Capital Securities. CPS II rank equally with Equal Ranking Capital Securities in respect of a redemption of, return of capital on, cancellation of or acquisition of CPS II and payment of declared but unpaid Dividends on a winding up of St. George.

56. Equal Ranking Capital Securities means in respect of a dividend or distribution, any equity, hybrid or subordinated debt capital security (whether comprised of one or more instruments) issued by St. George or a member of the Group which ranks for the payment of dividend or distribution equally with CPS II. Capital Securities which rank equally for the payment of dividend or distribution include CPS SAINTS, and SPS.

57. Holders of CPS II will not be entitled to speak or vote at any general meeting of St. George except in limited circumstances.

58. This Ruling is made on the basis that:

- (i) the Transaction Documents represent a complete and accurate description of the Transaction;
- (ii) the Transaction is implemented according to terms of the Transaction Documents;
- (iii) during the term of the Transaction, St. George will be a resident of Australia under the income tax laws of Australia and of no other jurisdiction;
- (iv) St. George and its Australian wholly-owned subsidiaries have made an election to form a consolidated group for tax purposes with effect from 1 October 2003;
- (v) 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 CPS II;
- (vi) the CPS II is properly characterised as an equity interest pursuant to Division 974 of the ITAA 1997;
- (vii) Dividends on the CPS II are frankable distributions pursuant to section 202-40 of the ITAA 1997;
- (viii) St. George will frank the distributions on the CPS II at the same franking percentage as the benchmark for the franking period in which the payments are made;

- (ix) the share capital of St. George will not become tainted within the meaning of Subdivision 197-A of the ITAA 1997 by an issue of the CPS II or the additional Ordinary Shares on Conversion of the CPS II;
- (x) the Ordinary Shares allotted in the event of Conversion of the CPS II are properly characterised as equity interests pursuant to Division 974 of the ITAA 1997;
- (xi) the Holders are residents of Australia for tax purposes;
- (xii) in determining whether a Holder is a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, a Holder and their associates have taken no positions (apart from the holding of the CPS II) in relation to their CPS II;
- (xiii) the Holders, or their associates, will not make any related payments (within the meaning of the former section 160APHN of the ITAA 1936) in relation to the Dividends on the CPS II;
- (xiv) Holders in receipt of Dividends on the CPS II will have held their CPS II for a period of at least 90 days (excluding the day of acquisition and the day of disposal), beginning on the day after the day on which the Holder acquired the CPS II and ending on the 90th day after the day on which the CPS II go ex-dividend;
- (xv) Dividends on the CPS II will be paid out of the retained profits of St. George;
- (xvi) the dividend payout ratios or the franking credits in relation to the ordinary share capital or other preference share capital (for example, SAINTS or SPS) of St. George are not expected to change as a result of the issue of CPS II; and
- (xvii) on the date of Conversion of the CPS II into Ordinary Shares in St. George, the rights and obligations attached to the Ordinary Shares are the same as those contained in the Constitution of St. George.

## **Ruling**

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### **Acquisition time of the CPS II**

59. Under section 109-10 of the ITAA 1997, each Holder acquired the CPS II on 28 December 2007, being the date the CPS II were issued to them.

## **CPS II cost base and reduced cost base**

60. Under subsections 110-25(2) and 110-55(2) of the ITAA 1997, the first element of the cost base and reduced cost base of each CPS II is \$100.

## **Inclusion of Dividends in assessable income**

61. Holders of CPS II must include in their assessable income all Dividends received in respect of their CPS II under subparagraph 44(1)(a)(i) of the ITAA 1936, and an amount equal to the franking credit received on those Dividends under Division 207 of the ITAA 1997.

## **Entitlement to a tax offset**

62. Holders will be entitled to a tax offset equal to the franking credit received on the Dividends under subsection 207-20(2) of the ITAA 1997.

## **Anti-avoidance provisions – imputation benefits**

63. 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 in relation to the Dividends received by the Holders of the CPS II.

64. 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 in relation to the Dividends received by the Holders of the CPS II.

## **Gross-up and tax offset denied in certain circumstances**

65. Section 207-145 of the ITAA 1997 will not apply to the whole, or any part, of the Dividends received by the Holders of the CPS II. Accordingly, section 207-145 of the ITAA 1997 will not adjust the gross-up of the Holders' assessable income to exclude the franking credit, nor will it deny the tax offset to which the Holders would have otherwise been entitled.

## **Franking credit subject to the refundable tax offset rules**

66. Holders of CPS II who are entitled to a tax offset under Division 207 of the ITAA 1997, in respect of franking credits received, will also be subject to the refundable tax offset rules in Division 67 of the ITAA 1997, unless specifically excluded under section 67-25 of the ITAA 1997 and who are not excepted from the exclusion. Such excluded entities include certain trustees and corporate tax entities under subsections 67-25(1A) to (1D) of the ITAA 1997.

**Conversion of each CPS II and allotment of additional St. George Ordinary Shares – capital gains tax (CGT) implications**

67. The Conversion of each CPS II into Ordinary Shares and the allotment of additional St George ordinary shares will not result in a CGT event for CGT purposes.

68. CGT event H2 in section 104-155 of the ITAA 1997 will not happen because on Conversion of each CPS II a cost base adjustment will be made to the CPS II as a consequence of the allotment of additional Ordinary shares. No other CGT event in Division 104 of the ITAA 1997 will happen because of the Conversion.

**Allotment of additional St. George Ordinary Shares – dividend**

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

**Allotment of additional St George Ordinary Shares – ordinary income**

70. The value of any additional St George Ordinary Shares issued on Conversion of the CPS II shares will not be assessable as ordinary income in the hands of the Holders under subsection 6-5(1) of the ITAA 1997.

**Cost base of the Ordinary Shares**

71. Either section 6BA of the ITAA 1936 or Subdivision 130-A of the ITAA 1997 will apply to apportion the first element of the cost base and reduced cost base of each CPS II over the Converted CPS II and any additional St. George Ordinary Shares allotted by St. George.

**Date of acquisition of the additional Ordinary Shares**

72. Under subsection 130-20(3) of the ITAA 1997, the additional Ordinary Shares are taken to be acquired at the time the CPS II were originally acquired by the Holders, being 28 December 2007.

## Appendix 1 – Explanation

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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 CPS II**

73. An equity interest that is issued or allotted by a company, is acquired when the contract is entered into or, if no contract exists, when the equity interests are issued or allotted: item 2 in the table in section 109-10 of the ITAA 1997.

74. Under the CPS II Prospectus, the CPS II offer opened on 27 November 2007 and had a staggered close in respect of the Securityholder Offer and Broker Firm Offer. St. George could withdraw or cancel the offer at any time before the issue date of 28 December 2007. The CPS II were issued on 28 December 2007.

75. For the purposes of item 2 in the table contained in section 109-10 of the ITAA 1997, the CPS II were acquired on 28 December 2007.

### **CPS II cost base and reduced cost base**

76. The first element of the cost base and reduced cost base includes the money paid, or required to be paid, in respect of acquiring a CGT asset: paragraph 110-25(2)(a) and subsection 110-55(2) of the ITAA 1997.

77. The Issue Price of the CPS II is \$100 per CPS II. Accordingly, when CPS II are issued, the first element of the cost base and reduced cost base of each CPS II is \$100.

### **Inclusion of Dividends in assessable income**

78. Subsection 44(1) of the ITAA 1936 provides, among other things, 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.

79. St. George advise the Dividends paid in respect of CPS II will be paid out of the retained profits of St. George. Accordingly, the Holders of CPS II must include the Dividend amount in their assessable income.

**Inclusion of franking credits in assessable income**

80. St. George advises that it expects the Dividends paid in respect of the CPS II to be fully franked. Under the Australian imputation system, where a franked distribution is paid by an Australian resident company to a shareholder, the assessable income of the shareholder must also include the franking credit attached to the dividend under Division 207 of the ITAA 1997. The inclusion of both the dividend and the associated franking credit in a shareholder's assessable income is termed 'grossing-up' the dividend receipt.

81. Accordingly, the franking credits attached to the Dividends received by the Holders of CPS II must be included in their assessable income.

**Entitlement to a tax offset**

82. In accordance with subsection 207-20(2) of the ITAA 1997, and with respect to the 'grossing-up' of the dividend receipt, the Holders are entitled to receive a tax offset equal to the value of the franking credit, which has been included in their assessable income.

**Anti-avoidance provisions – imputation benefits*****Section 204-30***

83. Subdivision 204-D of the ITAA 1997 broadly enables the Commissioner to make a determination where distributions with attached imputation benefits are streamed to members of a corporate tax entity.

84. 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 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.

85. The existence of these conditions enables the Commissioner, under paragraph 204-30(3)(c) of the ITAA 1997, to make a determination that no imputation benefit is to arise in respect of the distributions made to those favoured members.

86. Streaming is not defined for the purposes of Subdivision 204-D of the ITAA 1997, however, it is understood to refer to a company selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits: refer to paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002.

87. St. George have indicated in the CPS II Prospectus that Dividends paid to the Holders are expected to be fully franked. Although the CPS II rank ahead of Ordinary Shares in respect of the payment of Dividends, St. George have advised that they have, and will continue, to pay fully franked dividends (to the extent of available franking credits in their franking account) to all of its shareholders, including shareholders of Ordinary Shares. There will be no change in St. George's dividend franking policy or dividend payout ratios on its share capital as a result of the issue of the CPS II.

88. As such, there is no evidence that the requisite element of streaming exists in relation to the franked distributions to be paid by St. George to Holders of CPS II. Accordingly, based on the information provided, the Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny imputation benefits to Holders of CPS II.

### **Section 177EA**

89. 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. Where these circumstances arise, 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 generally; or
- denying the imputation benefit on the distribution that flowed directly or indirectly to the relevant taxpayer.

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

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
  - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or

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

91. It is considered that the conditions in paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied because:

- (a) the issue of CPS II constitutes a scheme for the disposition of a membership interest: paragraph 177EA(3)(a) of the ITAA 1936. Pursuant to paragraph 177EA(14)(a) of the ITAA 1936, a 'scheme for a disposition of membership interests or an interest in membership interests' includes a scheme that involves the issuing of membership interests. The issuance of CPS II on the terms set out in the CPS II Prospectus is a scheme that involves the issuing of membership interests because the holders of the CPS II are members of St. George and the CPS II are not debt interests: see sections 960-130 and 960-135 of the ITAA 1997;
- (b) frankable distributions are expected to be paid to the Holders of the CPS II: paragraph 177EA(3)(b) of the ITAA 1936. The Commissioner accepts that Dividends payable on the CPS II will be frankable distributions to the extent that the Dividends on the CPS II do not fall within the list in section 202-45 of the ITAA 1997;
- (c) franked distributions are expected to be paid to the Holders of the CPS II: paragraph 177EA(3)(c) of the ITAA 1936. It is expected that these distributions will be made on a quarterly basis. Furthermore, St. George has advised that it will continue its policy of fully franking all frankable distributions made by it, to the extent of the franking credits available in its franking account; and

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

92. Accordingly, the issue is whether having regard to the relevant circumstances of the scheme, it would be concluded that it was entered into or carried out for the purpose (which is not merely an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit under the scheme.

93. 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. 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 any one scheme.

94. St George advised that it redeemed its USD 250 million Depository Capital Securities in June 2007. Following the redemption, the St George group Tier 1 group capital adequacy ratio reduced to a ratio below what is required for APRA purposes. The issue of the CPS II is a capital raising transaction which St. George advised was undertaken to return St. George's Tier 1 Capital to within the range required by APRA. There is nothing in the Terms which would suggest it was entered into for the purpose (which is not merely an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit under the scheme.

95. Based on the information provided, and having regard to the factors listed in subsection 177EA(17) of the ITAA 1936, the qualifications set out in this Ruling and the relevant circumstances of the scheme, it would not be reasonable to conclude that in entering into the scheme, St. George and/or the Holders of the CPS II demonstrate the objective purpose of securing imputation benefits for the Holders of the CPS II. To the extent that any imputation benefits are secured, those benefits are considered to be incidental to the more significant objective purposes of the raising of Tier 1 Capital by St. George to meet its capital adequacy requirements.

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

### **Gross-up and tax offset denied in certain circumstances**

97. 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.

98. 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:

- the entity is not a 'qualified person' in relation to the distribution: 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 relation to the dividend: 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 relation to the distribution: paragraph 207-145(1)(c) of the ITAA 1997; or
- the dividend is made as part of a dividend stripping operation: paragraph 207-145(1)(d) of the ITAA 1997.

99. A person is a 'qualified person' for the purposes of Division 1A of former Part IIIA 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).

100. The holding period rule applies where no related payment has, or will be made, in respect of the dividend, and requires the shares to have been continuously held at risk throughout the primary qualification period: former paragraph 160APHO(1)(a) of the ITAA 1936.

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

102. The Holders of CPS II are qualified persons, provided that:

- the Holders in receipt of Dividends on the CPS II have held their CPS II at risk for a period of at least 90 days (excluding the day of acquisition and the day of disposal), beginning on the day after the day on which the Holder acquired the CPS II and ending on the 90th day after the day on which the CPS II go 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 Holders, nor associates of the Holders, are under an obligation to make, or are likely to make a related payment in relation to the Dividends: former paragraph 160APHO(1)(a) of the ITAA 1936 and former section 160APHN of the ITAA 1936.

103. In determining whether a Holder is a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, the Third Party Transfer facility contained in Clause 4 of the Terms, of itself, will not affect a Holder's risks of loss or opportunities for gain in respect of the CPS II.

104. The Commissioner has confirmed that he will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Dividends paid by St. George to Holders of CPS II.

105. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to section 207-155 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. The Transaction Documents provide no indication that the offering of CPS II and the associated payment of franked Dividends to the Holders in any way constitute a dividend stripping arrangement. As such, the dividend stripping provision will have no application to Holders of CPS II.

106. Accordingly, section 207-145 of the ITAA 1997 will not apply to deny imputation benefits to Holders of CPS II, as the requisite manipulation of the imputation system in respect of Dividends paid by St. George does not exist.

### **Franking credit subject to the refundable tax offset rules**

107. Holders of CPS II who are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 in respect of the grossing-up of their dividend receipts will also be subject to the refundable tax offset rules contained in Division 67 of the ITAA 1997, unless specifically excluded under subsections 67-25(1A) to (1D) of the ITAA 1997 and not being an exception to the excluded entities.

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

109. Accordingly, Holders of CPS II will be subject to the refundable tax offset rules unless they are listed as specifically excluded entities under section 67-25 of the ITAA 1997 and not excepted from the exclusion. Entities excluded by Division 67 of the ITAA 1997 include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions as set out in subsection 67-25(1C) or subsection 67-25(1D) of the ITAA 1997.

**Conversion of each CPS II and allotment of additional St. George Ordinary Shares – CGT implications**

110. Under the Transaction, each CPS II will Convert into one Ordinary Share through a variation of the rights attaching to each CPS II. Holders of the CPS II may also receive an allotment of additional St. George Ordinary Shares.

111. The CPS II will Convert into St. George Ordinary Shares on 20 August 2013, subject to the satisfaction of the Mandatory Conversion Conditions. If the Mandatory Conversion Conditions are not satisfied on that date, the Mandatory Conversion Date moves to the next Dividend Payment Date on which the conditions are satisfied. The CPS II may Convert earlier, if St. George elects to Convert CPS II into Ordinary Shares following the occurrence of certain events defined in the Terms.

112. Shares are 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 assets as defined by section 108-5 of the ITAA 1997, but rather combine to make up the ultimate asset, being the share for CGT purposes: refer to Taxation Ruling TR 94/30.

113. Under section 104-25 of the ITAA 1997, CGT event C2 happens if, among other things, the ownership of an intangible asset, such as a preference share, ends by the share:

- being redeemed or cancelled: paragraph 104-25(1)(a) of the ITAA 1997; or
- if the share is a convertible interest – being converted: paragraph 104-25(1)(f) of the ITAA 1997.

114. The mere variation of rights attaching to the CPS II is not a 'redemption' or 'cancellation' of the share for the purposes of paragraph 104-25(1)(a) of the ITAA 1997 and does not involve the conversion of the CPS II into equity interests for the purposes of paragraph 104-25(1)(f) of the ITAA 1997.

115. Furthermore, the relinquishment by the Holders of some of the rights attaching to the CPS II is not a CGT event that happens to part of the CGT asset comprised by each CPS II under section 112-30 of the ITAA 1997 (see Taxation Ruling TR 94/30, paragraph 40).

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

117. Subsection 104-155(1) of the ITAA 1997 provides that CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset that you own and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

118. The Conversion of CPS II and allotment of additional St. George Ordinary Shares will result in an adjustment to the cost base and reduced cost base of the CPS II under Subdivision 130-A of the ITAA 1997. Accordingly, there is no act, transaction or event that happens in relation to the CPS II that does not result in an adjustment to that CPS II's cost base and reduced cost base. Therefore, CGT event H2 does not happen because of the Conversion of CPS II when the Conversion includes the allotment of additional Ordinary Shares.

119. CGT event H2 will happen when the Conversion of each CPS II does not include the allotment of additional Ordinary shares as this is an act, transaction or event in relation to the CPS II that does not result in an adjustment being made to the cost base or reduced cost base of the CPS II.

120. A capital gain is made if the capital proceeds from CGT event H2 are more than the incidental costs incurred in relation to the event. A capital loss is made if the capital proceeds are less than the incidental costs.

121. Subsection 116-20(2) of the ITAA 1997 provides that the capital proceeds from CGT event H2 happening is the money or other consideration received, or entitled to be received, because of the act, transaction or event. Paragraph 29 of Taxation Ruling TR 95/3 provides that 'consideration' for these purposes can include the benefit of mutual promises flowing to parties even if those promises are not in themselves property.

122. In this case the Commissioner does not consider that the Conversion constitutes capital proceeds because of the H2 event happening.

123. It is only when a subsequent CGT event happens to the converted CPS II that any capital proceeds may be received. When that CGT event happens, any capital proceeds would relate to the subsequent CGT event and not to the CGT event H2 that happened on the Conversion.

124. Therefore, Holders will make no capital gain or capital loss from the happening of CGT event H2 as there are no capital proceeds because of the event and no incidental costs are incurred by the Holders in respect of the event.

125. No other CGT event in Division 104 of the ITAA 1997 will happen because of the Conversion.

**Allotment of additional St. George Ordinary Shares – dividend**

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

127. Although the additional St. George Ordinary Shares issued will constitute 'property' in the hands of the Holder, the allotment is not a disposition of property in the ordinary meaning of that expression (refer *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 a distribution of property by St. George.

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

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

**Allotment of additional St. George Ordinary Shares – ordinary income**

130. The allotment of additional St George Ordinary Shares will be a bonus issue within the meaning of paragraph 254A(1)(a) of the *Corporations Act 2001*, that is, an issue of shares for which consideration is not payable. The issue of additional shares will result in a re-expression of the Holder's interest in the share capital of St George. Accordingly, the value of any additional shares issued on Conversion will not be assessable as ordinary income under subsection 6-5(1) of the ITAA 1997 (*Commissioner of Taxation v. McNeil* (2007) 229 CLR 656; 2007 ATC 4223; (2007) 64 ATR 431).

**Cost base of the additional Ordinary Shares**

131. Either section 6BA of the ITAA 1936 or Subdivision 130-A of the ITAA 1997 will apply to apportion the first element of the cost base and reduced cost base of the CPS II over the Converted CPS II and any additional St. George Ordinary Shares issued by St. George.

132. 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.

133. Pursuant to subsection 6BA(3) of ITAA 1936, as the additional St. George Ordinary Shares are issued to Holders for no consideration and are not a dividend or taken to be a dividend, the issue price of the CPS II (being \$100 per CPS II) will be apportioned over the Converted CPS II and any additional St. George Ordinary Shares allotted.

134. Subdivision 130-A of the ITAA 1997 applies in a similar manner in respect of shares that are CGT assets. It provides special rules relating to the time of acquisition and the cost base of bonus equities for CGT purposes.

135. Section 130-20 of the ITAA 1997 sets out what happens if an entity owns shares in a company (the original equities) and the company issues other shares (the bonus equities) in relation to the original equities.

136. Under item 1 of the table in subsection 130-20(3) of the ITAA 1997, as the additional shares are not a dividend nor taken to be a dividend, the first element of the cost base and reduced cost base of each CPS II is to be apportioned over both the Converted CPS II and any additional Ordinary Shares issued to the Holders by St. George.

#### **Date of acquisition of the additional Ordinary Shares**

137. The Holders are taken to have acquired the additional Ordinary Shares at the time when the CPS II were originally acquired by the Holders, being 28 December 2007.

## **Appendix 2 – Detailed contents list**

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

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## References

### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 94/30; TR 95/3

### *Subject references:*

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

### *Legislative references:*

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ATO references

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ATOlaw topic: Income Tax ~~ Assessable income ~~ dividend, interest  
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Income Tax ~~ Capital Gains Tax ~~ CGT events H1 and  
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franking tax offset