


CR 2011/35 - Income tax: Suncorp-Metway Limited - allotment of Converting Preference Shares

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Class Ruling

Income tax: Suncorp-Metway Limited – allotment of Converting Preference Shares

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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, 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:

- subsection 44(1) of the ITAA 1936;
- section 45 of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 177EA of the ITAA 1936;
- former Division 1A of Part IIIA of the ITAA 1936;
- section 6-5 of the Income Tax Assessment Act 1997 (ITAA 1997);
- Division 67 of the ITAA 1997;
- Division 104 of the ITAA 1997;

- section 109-10 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- Subdivision 130-A of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- Division 207 of the ITAA 1997; and
- section 960-120 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are:
 - (a) Australian resident (within the meaning of subsection 6(1) of the ITAA 1936) subscribers (Holders) of Converting Preference Shares (CPS) in Suncorp-Metway Limited (Suncorp) who hold those CPS on capital account.
 - (b) are not subject to the Taxation of Financial Arrangements (TOFA) rules in Division 230 of the Income Tax Assessment Act 1997 in relation to financial arrangements under the scheme.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)
4. The class of entities to which this Ruling applies does not extend to investors in the CPS who acquired their CPS otherwise than by initial subscription.
5. The Ruling addresses the tax implications for Holders of the conversion of CPS into ordinary shares in Suncorp Group Limited (SGL), being a non-operating holding company that has been interposed between Suncorp and its shareholders subsequent to the previous Ruling.
6. This Ruling does not deal with how the taxation law applies to Holders who hold their CPS as trading stock or revenue assets.
7. This Ruling does not consider the tax implications of the Exchange of CPS by Redemption or Resale.
8. This Ruling does not consider how the taxation law applies to the Nominated Purchaser who acquires their CPS under the Resale facility.
9. 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.

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

Qualifications

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 17 to 54 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 7 January 2011 to 30 June 2014. The Ruling continues to apply after 30 June 2014 to all entities within the specified class who entered into the specified scheme at the time of the initial subscription for the CPS. 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).

Previous Rulings

16. This Class Ruling replaces CR 2008/57 which is withdrawn on and from 6 April 2011 due to a change in the Scheme. CR 2008/57 will continue to apply to Investors who entered into the arrangement on or before 7 January 2011.

Scheme

17. The following description of the scheme is based on the following information provided by the applicant:

- application for Class Ruling dated 14 October 2010;
- Prospectus dated 14 May 2008 for the issue of CPS by Suncorp (Prospectus);
- Supplementary Prospectus dated 4 June 2008 and related to the Prospectus (Supplementary Prospectus);
- CPS Terms contained in Annexure A of the Prospectus (the Terms);
- Amended CPS Terms dated 15 November 2010 (Appendix B to the application);
- Draft Explanatory Memorandum for Suncorp-Metway Limited dated 12 October 2010; and
- Suncorp's Media Release dated 13 June 2008.

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

18. In this Ruling, unless otherwise defined, capitalised terms take the meaning as per the Prospectus.

19. Suncorp is an Australian resident company.

20. By prospectus dated 14 May 2008, Suncorp announced its intention to undertake a capital raising by means of the issue of CPS.

21. The capital raised from the issue of the CPS will be used to fund and support organic growth and to optimise Suncorp's capital structure within the guidelines prescribed by the Australian Prudential Regulation Authority (APRA).

22. On 12 June 2008 Suncorp allotted 7.35 million CPS, which raised \$735 million.

23. The classes of applicants for CPS and how they apply for the CPS were described in the Prospectus as follows:

- Securityholder Applicant – a holder of Ordinary Shares, RPS (the reset preference shares issued by Suncorp according to the terms of issue set out in the information memorandum dated 16 August 2001 and in the placement offer letter dated 3 September 2001) or Floating Rate Capital Notes shown on the Register with an address in Australia – through the Securityholder Offer;

- General Applicant – an Australian resident who is neither a Securityholder Applicant, Broker Firm Applicant nor Institutional Investor – through the General Offer;
- Broker Firm Applicant – a client of a Syndicate Broker (whether an Australian resident or not) – through the Broker Firm Offer; and
- Institutional Investors – an investor (whether an Australian resident or not) who has been invited by the Joint Lead Managers to bid for CPS in the Bookbuild and who is not a Broker Firm Applicant – through the Institutional Offer.

24. The Prospectus states that no action has been taken to register or qualify the CPS or the Offer or to otherwise permit a public offering of the CPS outside Australia. It further states that the Joint Lead Managers and Syndicate Brokers may offer the CPS outside Australia under the Institutional Offer or Broker Firm Offer where such offer is made in accordance with the laws of that jurisdiction. Suncorp confirmed that the CPS were offered to non-resident (sophisticated) investors.

25. The CPS Terms were amended on 15 November 2010 as a consequence of the interposition of a non-operating holding company (that is SGL) between Suncorp and its shareholders.

Main features of the CPS

26. The CPS are fully paid mandatorily convertible preference shares in the capital of Suncorp.

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

28. The CPS are listed on the Australian Securities Exchange (ASX) and traded under the ASX code 'SUNPB'.

Dividend Calculation

29. The Holder of each CPS is entitled to receive on the relevant Dividend Payment Date a dividend (Dividend) payable in arrears (starting 14 September 2008) calculated using the formula:

$$\text{Dividend} = ((\text{Issue Price} \times \text{Dividend Rate} \times N) / 365)$$

where:

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

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

where:

Bank Bill Rate (expressed as a percentage per annum) means, for a Dividend Period, the average mid-rate for bills of a term of 90 days which average rate is displayed on Reuters page BBSW (or any page which replaces that page) on the first Business Day of the Dividend Period or if there is a manifest error in the calculation of that average rate or that average rate is not displayed by 10.30am (Sydney time) on that date, the rate specified in good faith by Suncorp at or around that time on that date having regard, to the extent possible, to:

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

Margin (expressed as a percentage per annum) means the margin determined under the Bookbuild; and

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

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

30. The Dividend Payment Dates are each 14 March, 14 June, 14 September and 14 December, until (but not including) the date on which Redemption, Conversion or Resale occurs, in which case that date will constitute a Dividend Payment Date.

31. The Dividends are expected to be fully franked. However, if any dividend is not franked or only partially franked, the Dividend will be grossed-up to the extent that the franking percentage of the Dividends is less than 100%, as determined by the calculation in clause 2.2 of the Terms.

Dividend payment conditions

32. Each Dividend (including an Optional Dividend) is subject to:

- the Directors, at their absolute discretion, determining the Dividend to be payable;
- payment of the Dividend being in compliance with all applicable laws; In respect of this, the applicant has acknowledged and confirmed that dividends will be subject to Suncorp Group Limited being in a net asset position in accordance with and compliant to section 254T of the *Corporations Act 2001*(Corporations Act);

- unless APRA otherwise agrees, payment of the Dividend not resulting in the Prudential Capital Ratio or the Tier 1 Capital Ratio of Suncorp (on a Level 1 basis) or of the Suncorp Banking Group not complying with APRA's then current capital adequacy guidelines as they are applied to Suncorp or the Suncorp Banking Group (as the case may be) at the time;
- unless APRA otherwise agrees, the amount of the Dividend not exceeding Distributable Profits;
- payment of the Dividend not resulting in Suncorp becoming, or being likely to become, insolvent for the purposes of the Corporations Act; and
- APRA not otherwise objecting to the payment of the Dividend.

33. The Directors, in their absolute discretion but with the prior written approval of APRA, may determine an Optional Dividend to be payable on any date, subject to the above conditions.

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

35. 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 Suncorp, and the Holders have no claim in respect of such non-payment.

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

Restrictions in the case of non-payment of Dividends

37. If a Dividend has not been paid in full within 20 Business Days after the relevant Dividend Payment Date, neither SGL nor Suncorp must (without approval of a Special Resolution) declare or pay a dividend or make any distribution on certain capital instruments (which rank equally with or junior to the CPS) of Suncorp or redeem, buy-back or reduce capital on certain capital instruments (which rank equally with or junior to the CPS) unless:

- four consecutive Dividends scheduled to be payable on the CPS after the Dividend Payment Date of the Dividend that has not been paid have been paid in full;
- with the prior written approval of APRA, an Optional Dividend has been paid to the Holders equal to the aggregate unpaid amount of any unpaid Dividends which were scheduled to be paid in the 12 months prior to the date of payment of the Optional Dividend; or
- all CPS have been Redeemed or Converted.

Mandatory Conversion

38. Suncorp must Convert all CPS on issue into SGL Ordinary Shares on the Mandatory Conversion Date.

39. The Mandatory Conversion Date is 14 June 2013 provided all the Mandatory Conversion Conditions are satisfied. If any of the Mandatory Conversion Conditions are not satisfied on 14 June 2013 the Mandatory Conversion Date will be deferred until the next Dividend Payment Date on which the Mandatory Conversion Conditions are satisfied.

40. The Mandatory Conversion Conditions are:

- the Volume Weighted Average Sale Price (VWAP) on the 25th Business Day on which trading in SGL Ordinary Shares took place immediately preceding (but not including) the Relevant Date (the First Test Date) is greater than 55.55% of the Issue Date VWAP;
- the VWAP during the period of 20 Business Days on which trading in SGL Ordinary Shares took place immediately preceding (but not including) the Relevant Date is greater than 50.51% of the Issue Date VWAP; and
- no Delisting Event applies in respect of the Relevant Date.

41. On Conversion, each CPS will Convert into SGL Ordinary Shares by the following means:

- The automatic transfer of a Holder's CPS to SGL or to a member of the SGL Group elected by SGL on the Mandatory Conversion Date; and
- The issue to a Holder of a number of SGL Ordinary Shares for each CPS that is being Converted on the Mandatory Conversion Date equal to the Conversion Number, calculated as follows:

$$\text{Conversion Number} = 99\% \times \frac{\text{Issue Price}}{\text{VWAP}}$$

Where:

VWAP (expressed in dollars and cents) means the VWAP during the VWAP Period.

42. The total market value of the SGL Ordinary Shares held by a Holder immediately after the Conversion of the CPS will approximate the Issue Price of the CPS (\$100).

43. If for any reason the transfer of the CPS described in paragraph 41 is not completed, then a Holder will be taken to:

- Hold the CPS on trust for SGL; and
- Irrevocably direct Suncorp to pay all amounts payable in respect of those CPS to SGL as and when they fall due.

Furthermore, the CPS will be taken to have Converted into SGL Ordinary Shares.

Redemption

44. If any of the Mandatory Conversion Conditions are not satisfied, Suncorp may (subject to APRA giving its prior written approval) Redeem all CPS. Otherwise Conversion is deferred until the next Dividend Payment Date on which all the Mandatory Conversion Conditions are satisfied.

45. 'Redeem' means redeem, buy-back (other than an on-market buy-back within the meaning of the Corporations Act) or reduce capital, or any combination of such activities.

46. The CPS will be Redeemed by payment of the Issue Price. However, where the Redemption involves a buy-back of the CPS, the Directors may determine that the consideration payable for each CPS that is bought back will include an amount equal to a Dividend for that Dividend Period as well as the Issue Price.

Resale

47. Whether or not the Mandatory Conversion Conditions are satisfied in relation to a Relevant Date, Suncorp may elect to Resell all (but not some) CPS on the Relevant Date. If Suncorp elects to Resell, Suncorp must appoint one or more Nominated Purchasers for the Resale upon such terms as may be agreed between Suncorp and the Nominated Purchaser. The Nominated Purchaser undertakes to acquire the CPS from the Holders for the Issue Price.

48. Each Holder is taken irrevocably to offer to sell the CPS to the Nominated Purchaser for cash equivalent to the Issue Price. Subject to payment by the Nominated Purchaser of the Issue Price to the Holders, all right, title and interest in such CPS will be transferred to the Nominated Purchaser on the Relevant Date or the Exchange Date (as the case may be).

Exchange

49. Suncorp may elect to Exchange all (but not some) of the CPS on an Exchange Date following the occurrence of a Tax Event or a Regulatory Event.

50. If Suncorp elects to Exchange the CPS, it must elect which of the following (or which combination of the following) it intends to do in respect of the CPS:

- subject to APRA's prior written approval and the satisfaction of either of the Optional Conversion Conditions, Convert the CPS into SGL Ordinary Shares;
- subject to APRA's prior written approval, Redeem the CPS; or
- Resell the CPS.

51. If an Acquisition Event occurs, Suncorp must, subject to obtaining the prior written approval of APRA, Exchange all CPS on the Acquisition Exchange Date.

CPS general rights

52. The CPS do not represent a deposit liability of Suncorp and are unsecured. The CPS rank equally among themselves and with the RPS in all respects. On a winding up, the CPS rank:

- in priority to Ordinary shares; and
- subordinate to the Non-Participating Shares and to any depositors and creditors of Suncorp.

53. The CPS generally do not have voting rights, except in the limited circumstances described in the Terms.

Other matters

54. The Ruling is made on the basis that:

- (a) the Transaction Documents represent a complete and accurate description of the Transaction, are intended by parties to have their legal effect and will be implemented according to their terms;
- (b) during the term of the Transaction, Suncorp will be a resident of Australia under the income tax laws of Australia and of no other jurisdiction;
- (c) all parties to the Transaction are dealing with each other on arm's length terms and fair value consideration will be provided by the Holders to acquire the CPS;
- (d) the CPS are equity interests in Suncorp pursuant to Division 974 of the ITAA 1997;
- (e) dividends on the CPS will be frankable distributions pursuant to section 202-40 of the ITAA 1997;

- (f) Suncorp/SGL will frank the distributions on the CPS at the same franking percentage as the benchmark for the franking period in which the payments are made;
- (g) the share capital of Suncorp/SGL will not become tainted within the meaning of Subdivision 197-A of the ITAA 1997 by an issue of the CPS or the SGL Ordinary Shares on conversion of the CPS;
- (h) the majority of the Holders are expected to be residents of Australia for tax purposes, although some may be non-residents;
- (i) the CPS are expected to be treated as a liability for AIFRS purposes;
- (j) for the purposes of determining whether a Holder is a 'qualified person' in relation to a distribution for the purposes of the former Division 1A of Part IIIA of the ITAA 1936, a Holder has taken no positions (apart from the holding of the CPS) in relation to their CPS and will not be under an obligation or is likely to make a related payment in relation to the Dividends;
- (k) the Holders, or their associates, will not make any related payments (within the meaning of former section 160APHN of the ITAA 1936) in relation to the dividends on the CPS;
- (l) the Holders in receipt of Dividends on the CPS will have held their CPS for a period of at least 90 days (excluding the day of disposal), within the period beginning on the day after the day on which the Holder acquired the CPS and ending on the 90th day after the day on which the CPS go ex-dividend;
- (m) dividends on the CPS will be paid out of the retained profits of Suncorp; and
- (n) the dividend payout ratios or the franking credits in relation to the ordinary share capital or other preference share capital of Suncorp have not changed as a result of the issue of the CPS.

Ruling

Acquisition time of the CPS

55. Under section 109-10 of the ITAA 1997, the Holders acquired the CPS on 12 June 2008, being the date the CPS were issued to them.

CPS cost base and reduced cost base

56. 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 is \$100.

Inclusion of Dividends in assessable income

57. The Holders must include in their assessable income all Dividends received in respect of their CPS 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

58. The 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.

59. The Holders 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.

Imputation benefits

60. 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 in respect of the CPS.

Determination under paragraph 177EA(5)(b)

61. 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 in respect of the CPS.

Gross up

62. Section 207-145 of the ITAA 1997 will not apply to the whole, or any part, of the Dividends received by the Holders. 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.

Qualified person and the Resale facility

63. Under the former definition of 'qualified person', the Resale facility contained in clause 8 of the Terms, of itself, will not affect a Holder's risks of loss or opportunities for gain in respect of the CPS on the basis that it does not constitute a separate position for the purposes of former Division 1A of Part IIIAA of the ITAA 1936.

Conversion of each CPS – capital gains tax (CGT) implications

64. The Conversion of each CPS into SGL Ordinary Shares will result in CGT event C2 occurring. However, no Holder will make a capital gain or capital loss, as the capital gain or capital loss is disregarded under subsection 130-60(3) of the ITAA 1997.

Section 45

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

Section 45A

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

Section 45B

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

Cost base of the SGL Ordinary Shares

68. Pursuant to item 2 of the table in subsection 130-60(1) of the ITAA 1997, the first element of the cost base and the reduced cost base of each SGL Ordinary Share allocated to a Holder will be their cost base in the CPS at the time of Conversion plus any additional amounts paid to convert the CPS divided by the number of SGL shares they receive for each CPS.

Acquisition time of SGL Ordinary Shares

69. Under subsection 130-60(2) of the ITAA 1997, the SGL Ordinary Shares are taken to be acquired at the time of the Conversion of the CPS.

SGL Interposition

70. CGT event H2 (section 104-155 of the ITAA 1997) happened in respect of the CPS held by the Holders as a result of the amendments to the terms of the CPS as a consequence of the interposition of a non-operating holding company (i.e SGL) between Suncorp and its shareholders. However, no Holder made a capital gain or a capital loss as there were no capital proceeds because of the event, and no incidental costs were incurred in respect of the event. No other CGT event happened to the Holders as a result of these amendments to the terms of the CPS.

Commissioner of Taxation

6 April 2011

Appendix 1 – Explanation

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

Acquisition time of the CPS

71. 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).

72. The CPS were issued on 12 June 2008. Therefore, for the purposes of item 2 in the table contained in section 109-10 of the ITAA 1997, the CPS were acquired on 12 June 2008.

CPS cost base and reduced cost base

73. 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).

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

Inclusion of Dividends in assessable income

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

76. Suncorp advises that the Dividends paid in respect of the CPS will be paid out of Suncorp's retained profits. Accordingly, the Holders must include the Dividend amount in their assessable income.

77. Suncorp/SGL advises that it expects the Dividends paid in respect of the CPS to be fully franked.

78. 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.

79. Accordingly, the franking credits attached to the Dividends received by the Holders must be included in their assessable income.

80. 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.

Franking credit subject to the refundable tax offset rules

81. The Holders who are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 in respect of the franking credit received, will also be subject to the refundable tax offset rules contained in Division 67 of the ITAA 1997, unless specifically excluded under section 67-25 of the ITAA 1997.

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

83. Accordingly, the Holders 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.

84. 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 subsections 67-25(1C) or 67-25(1D) of the ITAA 1997.

Imputation benefits – streaming of imputation benefits

85. 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.

86. 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 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).

87. '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).

88. Suncorp/SGL has indicated that all the Holders will receive fully-franked Dividends regardless of their tax attributes or their individual tax position and the dividend payout ratios or franking credits in relation to the SGL Ordinary Shares or other preference shares will not be affected by the issue of the CPS. Suncorp/SGL has further advised that the CPS were offered to non-resident sophisticated investors.

89. Further, the SGL Ordinary Shares issued on Conversion of the CPS will not attract the application of section 204-30 of the ITAA 1997. This is because the issue of the SGL Ordinary Shares does not constitute a distribution and the issue of SGL Ordinary Shares will not affect Suncorp/SGL's fully franked dividend policy on its share capital.

90. Based on the information provided, it is not concluded that the requisite element of streaming exists in relation to the franked distributions to be paid by Suncorp/SGL to the Holders. 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 the Holders.

Determination under paragraph 177EA(5)(b)

91. 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.

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

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

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

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

- (a) the issue of CPS constitutes a scheme for the disposition of a membership interest (paragraph 177EA(3)(a) of the ITAA 1936). Pursuant to paragraph 177EA(14)(a) of the ITAA 1936, a 'scheme for a disposition of membership interests or an interest in membership interests' includes a scheme that involves the issuing of membership interests. The issuance of CPS on the terms set out in the CPS Prospectus is a scheme that involves the issuing of membership interests because, once the CPS are issued, the Holders are members of Suncorp and the CPS are not debt interests (sections 960-130 and 930-135 of the ITAA 1997);
- (b) frankable distributions are expected to be payable to the Holders (paragraph 177EA(3)(b) of the ITAA 1936). The Commissioner accepts that Dividends payable on the CPS will be frankable distributions to the extent that the Dividends on the CPS do not fall within the list of unfrankable distributions 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 these distributions will be made on a quarterly basis. Furthermore, Suncorp/SGL 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 given that Suncorp/SGL expects to frank the distributions on the CPS: paragraph 177EA(3)(d) of ITAA 1936.

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

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

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

96. Suncorp advised that it will issue the CPS as part of its ongoing capital management strategy to support ongoing growth in risk-weighted assets and to provide Suncorp with Tier 1 capital as required by APRA for capital adequacy purposes. A consideration of all the terms does not lead to the conclusion that 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.

97. 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, Suncorp and/or the Holders demonstrate the objective purpose of securing imputation benefits for the Holders. 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 Suncorp to meet its capital adequacy requirements.

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

Gross up

99. 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.

100. 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).

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

102. 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).

103. 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).

104. The Holders are qualified persons, provided that:

- the Holders, in receipt of Dividends on the CPS will have held their CPS at risk for a period of at least 90 days, beginning on the day after the day on which the Holders acquired the CPS and ending on the 90th day after the day on which the CPS 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).

105. If either or both of the above two considerations are not met, the Holders will not be a 'qualified person' for the purposes of former Division 1A of Part IIIAA of the ITAA 1936. Subdivision 207-F of the ITAA 1997 will create the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for the Holders.

106. 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 Suncorp to the Holders (see paragraphs 60 and 61 of this Ruling).

107. 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.

108. The Transaction Documents provide no indication that the offering of the CPS 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 the Holders.

Qualified person and the Resale facility

109. 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. In accordance with the former subsection 160APHJ(2) of the ITAA 1936, a position in relation to a share is anything that has a 'delta' in relation to that share.

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

111. Under the Resale facility, Suncorp can elect to require all the Holders to sell their CPS to a Nominated Purchaser. Accordingly, any Nominated Purchaser, until nominated by Suncorp, has no right or ability to trigger Redemption or call for CPS from the Holders.

112. Suncorp is also not required to exercise the Resale facility and has not appointed any Nominated Purchaser. It follows that the Resale facility is an option that is held by Suncorp, the issuer of the share, and not by a third party. The Resale facility therefore does not represent a separate position in relation to the CPS for the purposes of former Division 1A of Part IIIAA of the ITAA 1936.

113. Therefore, it is considered that the Resale facility does not affect a Holder's risk of loss or opportunities for gain in respect of the CPS.

Conversion of each CPS – CGT implications

114. On Conversion, each CPS will Convert into SGL Ordinary Shares by the following means:

- the automatic transfer of a Holder's CPS to SGL or a member of the SGL Group elected by SGL on the Mandatory Conversion Date; and
- the issue to a Holder of a number of SGL Ordinary Shares for each CPS that is being Converted on the Mandatory Conversion Date equal to the Conversion Number, calculated as follows:

$$\text{Conversion Number} = 99\% \times \frac{\text{Issue Price}}{\text{VWAP}}$$

Where:

VWAP (expressed in dollars and cents) means the VWAP during the VWAP Period.

115. The CPS will Convert into SGL Ordinary Shares on 14 June 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 may Convert earlier, if Suncorp/SGL elects to Convert the CPS into SGL Ordinary Shares following the occurrence of certain events defined in the Terms.

116. Under section 104-25 of the ITAA 1997, CGT event C2 happens if, among other things, the ownership of an intangible asset that is a convertible interest ends by the conversion of the asset into another asset (paragraph 104-25(1)(f) of the ITAA 1997).

117. However, Subdivision 130-C applies to the acquisition of shares by the conversion of a convertible interest. In order for this subdivision to apply to the conversion of the CPS, the CPS must be a convertible interest. If the CPS is a convertible interest any capital gain or capital loss made under CGT event C2 happening in respect to the conversion of the CPS is disregarded (see paragraph 123 of this Ruling).

118. A convertible interest in a company is defined in section 995-1 as an interest of the kind referred to in item 4 of the table in subsection 974-75(1). Paragraph (b) of that item describes an interest that will or may convert into an equity interest in the company or a connected entity of the company.

119. In the present circumstances, the CPS issued by Suncorp will Convert into SGL Ordinary Shares issued by SGL. Therefore, SGL must satisfy the definition of a connected entity.

120. The term 'connected entity' is defined in section 995-1. That definition includes, as a connected entity, an 'associate' of the entity being tested. Associate is widely defined in sections 995-1 and 318 of the ITAA 1936. As SGL will be the parent company of Suncorp at the time of the Conversion, SGL will be an associate, and thus a connected entity, of Suncorp.

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

122. Upon Conversion, the CPS will satisfy this requirement on the basis that under the CPS Terms, the CPS will be Exchanged for SGL Ordinary Shares.

123. Accordingly, upon Conversion, CPS Holders will disregard any capital gain or loss arising from that Conversion pursuant to subsection 130-60(3).

Section 45

124. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

125. Suncorp/SGL has consistently paid fully franked dividends and has stated it will pay fully franked dividends to all its shareholders, including the Holders, to the extent of the franking credits in its franking account. Furthermore, the Terms of the CPS do not allow Suncorp to issue Ordinary Shares to all or some of the Holders in satisfaction of their dividend entitlements in relation to the CPS.

126. Therefore, section 45 of the ITAA 1936 will not apply to the SGL Ordinary Shares acquired on Conversion of the CPS.

Section 45A

127. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

128. The issue of SGL Ordinary Shares to the Holders is a provision of capital benefits pursuant to paragraph 45A(3)(a) of the ITAA 1936.

129. The issue of SGL Ordinary Shares is in effect a replacement of the Holders' interest in the capital of Suncorp for capital in SGL, and as such is a restatement of the Holder's capital in the SGL Group. Without more, it does not constitute the streaming of capital benefits.

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

Section 45B

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

132. The issue of SGL Ordinary Shares on Conversion of the CPS is a scheme under which a capital benefit is provided to the Holders (paragraph 45B(5)(a) of the ITAA 1936).

133. For the provision to apply paragraph 45B(2)(c) requires that, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit. The relevant circumstances of the scheme are listed in subsection 45B(8) of the ITAA 1936.

134. The provision of SGL Ordinary Shares is not in satisfaction of the Holders' entitlement to dividends but a mere conversion of the CPS held by the Holders. Consequently, each Holder's interest in the share capital of Suncorp will merely be replaced with an interest in the share capital of SGL when the capital benefit is provided. Furthermore, Suncorp/SGL has paid and has stated it will continue to pay fully franked dividends to all its shareholders to the extent of the franking credits available.

135. Having regard to the relevant circumstances of the scheme as required by subsection 45B(8) of the ITAA 1936, it would not be concluded that any of the parties to the scheme entered into or carried out the scheme for a more than incidental purpose of enabling the Holders to obtain a tax benefit. Therefore, section 45B of the ITAA 1936 will not apply to treat the SGL Ordinary Shares acquired on Conversion as an unfranked dividend in the hands of the Holders.

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

Cost base of the SGL Ordinary Shares

137. Pursuant to item 2 of the table in subsection 130-60(1) of the ITAA 1997, the first element of the cost base and the reduced cost base of each SGL Ordinary Share allocated to a Holder will be their cost base in the CPS at the time of Conversion divided by the number of SGL shares they receive for each CPS.

Acquisition time of the SGL Ordinary Shares

138. Under subsection 130-60(2) of the ITAA 1997, the SGL Ordinary Shares are taken to be acquired at the time of the Conversion of the CPS. This means that the 12 month holding period for the purposes of the CGT discount, as regards the SGL Ordinary Shares, will run from the acquisition date of the SGL Ordinary Shares and not from the acquisition of the CPS.

SGL Interposition

139. The interposition of a non-operating holding company (that is SGL) between Suncorp and its shareholders will not result in a CGT event for Holders for CGT purposes.

140. 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.

141. The amendment to the terms of the CPS, as a consequence of the interposition of a non-operating holding company (i.e SGL) between Suncorp and its shareholders, results in CGT event H2 happening for Holders for CGT purposes. The amendment to the terms of the CPS is an act, transaction or event in relation to the CPS that does not result in an adjustment being made to the cost base or reduced cost base of the CPS.

142. A capital gain is made if the capital proceeds from the 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 (subsection 104-155(3) of the ITAA 1997).

143. 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 entitles to be received, because of the act, transaction or event.

144. Holders make no capital gain or capital loss from the happening of CGT event H2 as there are no capital proceeds because of the amendments to the terms of the CPS and no incidental costs are incurred by the Holders that relate to these amendments. No other CGT event will happen because of the amendments to the terms of the CPS.

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10, TD 2007/29

Previous Rulings

CR 2008/57

Subject references:

- acquisition dates
- capital gains tax
- CGT cost base
- conversion of securities
- dividend imputation
- franking credits
- CGT events C1-C3 – end of a CGT Asset
- CGT event H1-H2 – special capital receipts

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ATOlaw topic: Income Tax ~~ Assessable income ~~ dividend, interest and royalty income
Income Tax ~~ Capital Gains Tax ~~ cost base and reduced cost base
Income Tax ~~ Capital Gains Tax ~~ CGT events H1 and H2 - special capital receipts
Income Tax ~~ Tax offsets, credits and benefits ~~ franking tax offset