CR 2012/25 - Income tax: Insurance Australia Group Limited - issue of convertible preference shares

Class Ruling

Income tax: Insurance Australia Group Limited – issue of convertible preference shares

Contents | Para

This publication provides you with the following level of protection:

It is not intended that this draft class ruling be relied upon. It is not a publication approved in writing by the Commissioner. Consequently, there is no automatic protection against liability for tax shortfall, penalty and interest charges if a taxpayer seeks to rely on statements in the draft ruling.

When it issues, the class ruling will have the following preamble:

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

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

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

What this Ruling is about

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

Relevant provision(s)

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

- section 6 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 6BA of the ITAA 1936;
- subsection 44(1) of the ITAA 1936;
- section 45 of the ITAA 1936;
- section 45A of the ITAA 1936;

- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 177EA of the ITAA 1936;
- subsection 6-5(2) of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 67 of the ITAA 1997;
- Division 104 of the ITAA 1997;
- section 108-5 of the ITAA 1997;
- section 109-10 of the ITAA 1997;
- subsection 110-25(2) of the ITAA 1997;
- subsection 110-55(2) of the ITAA 1997;
- section 112-30 of the ITAA 1997;
- Subdivision 130-A of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 202-45 of the ITAA 1997;
- subsection 205-15(1) of the ITAA 1997;
- subsection 207-20(1) of the ITAA 1997;
- subsection 207-20(2) 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 subscribers for convertible preference shares (CPS) in Insurance Australia Group Limited (IAG) who hold those shares on capital account and are 'Australian residents' (within the meaning of subsection 995-1(1) of the ITAA 1997 during the period in which they hold the CPS (referred to in this Ruling as 'CPS Holders').

4. The class of entities to which this Ruling applies does not extend to the CPS Holders who did not acquire their interest by initial subscription.

5. This Ruling does not apply to CPS Holders for whom gains and losses from the CPS are subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997.

(Note – Division 230 of the ITAA 1997 will not generally apply to the financial arrangements of individuals, unless they have made an election for those rules to apply to them.)

6. This Ruling does not apply to CPS Holders where Dividends paid in respect of CPS are either exempt income (within the meaning of section 6-20 of the ITAA 1997) or non-assessable non-exempt income (within the meaning of section 6-23 of the ITAA 1997) in their hands.

7. This Ruling does not consider the tax implications of the Optional Exchange under clause 5 and the early exchange on Acquisition Event under clause 6 of the CPS Terms.

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

Qualifications

9. 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 13 to 51 of this Ruling.

10. 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.

Date of effect

12. This Ruling applies from 1 May 2012 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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).

Scheme

13. The following description of the scheme is based on information provided by King & Wood Mallesons (Applicant). The following documents, or relevant parts of them, as the case may be, form part of and are to be read with the description:

- application for Class Ruling dated 3 February 2012 lodged by the Applicant on behalf of IAG;
- Prospectus 'Insurance Australia Group convertible preference shares' dated 19 March 2012;
- CPS Terms in Appendix A of the Prospectus; and
- correspondence received from the Applicant providing further particulars.

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

14. In this Ruling, unless otherwise indicated, capitalised terms take on the same meaning as in the Prospectus and CPS Terms.

15. During the term of the scheme, IAG will be a resident of Australia under the income tax laws of Australia and of no other jurisdiction.

16. IAG has applied for the CPS to be quoted on the Australian Securities Exchange (ASX) and the CPS are expected to trade under ASX code IAGPC.

17. The Offer contained in the Prospectus is the offering of 3.5 million CPS at $100 per CPS to raise $350 million, with the ability to raise more or less.

18. The capital raised from the issue of the CPS will be used for IAG's general corporate purposes (including the refinancing of IAG's reset preference shares (RPS)), and the Offer is part of IAG's continuing capital management strategy within the guidelines prescribed by the Australian Prudential Regulation Authority (APRA).

19. The classes of investors who can apply to subscribe for CPS under the Offer, and the corresponding process for lodging applications as described in the Prospectus are:

- Institutional Investors — an investor who is invited by the Joint Lead Managers to bid for CPS in the Bookbuild and who is applying through the Institutional Offer (provided that such investor may not be in the United States);
- Broker Firm Applicants — an Australian resident or high net worth client of a Syndicate Broker invited to participate through the Broker Firm Offer;

- RPS Holder Applicants — an Eligible RPS Holder who is applying through the Reinvestment Offer; and
- General Applicants — a member of the general public who is resident in Australia applying through the General Offer.

20. The Prospectus states that no action has been taken to register or qualify the Prospectus, CPS or the Offer, or to otherwise permit a public offering of CPS in any jurisdiction outside Australia. However, subject to IAG approval, CPS may be offered in certain permitted jurisdictions outside Australia under the Institutional Offer where such offer is made, and accepted, in accordance with the laws of such jurisdictions.

Main features of CPS

21. A CPS is a perpetual fully paid non-cumulative preference share in the capital of IAG which will mandatorily convert into Ordinary Shares on 1 May 2019 (subject to the Mandatory Conversion Conditions in the CPS Terms being satisfied), unless the CPS are otherwise Exchanged in accordance with the CPS Terms.

22. The issue price of each CPS will be $100 (Issue Price) and on issue, will be fully paid.

23. A CPS Holder does not have voting rights, except in the limited circumstances described in clause 10.1 of the CPS Terms.

Dividend calculation

24. Subject to the CPS Terms, each CPS entitles the CPS Holder on a Record Date for that Dividend to receive on the relevant Dividend Payment Date a Dividend calculated using the following formula:

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

where:

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

$$\textbf{Dividend rate} = (\textbf{Bank Bill Rate} + \textbf{Margin}) \times (1 - \textbf{T})$$

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 180 days which average mid-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 mid-rate or that average mid-rate is not displayed by 10:30am (Sydney time) on that date, the rate specified in good faith by IAG at or around that time having regard, to the extent possible, to:

(a) the rates otherwise bid and offered for bills of a term of 180 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 180 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

T (expressed as a decimal) means the Australian corporate tax rate applicable to the franking account of IAG at the relevant Dividend Payment Date

N means in respect of:

(a) the first Dividend Payment Date, the number of days from (and including) the Issue Date until (but not including) the first Dividend Payment Date; and

(b) each subsequent Dividend Payment Date, the number of days from (and including) the preceding Dividend Payment Date until (but not including) the relevant Dividend Payment Date.

25. Dividends are expected to be paid semi-annually in arrears. The Dividend Payment Dates are:

- each 1 May and 1 November, commencing on 1 November 2012 until (but not including) the date on which a Redemption or Conversion of that CPS occurs; and
- each date on which
  - a Conversion of that CPS occurs; and
  - subject to clause 8.3(a)(iii) of the CPS Terms, a Redemption of that CPS occurs.

26. CPS Holders are expected to receive cash Dividends which have been fully or substantially franked. All CPS Holders will receive fully or substantially franked dividends regardless of their tax attributes or their individual tax position. 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 Dividend is less than 100% by a factor that reflects the Australian corporate tax rate, as determined by clause 2.2 of the CPS Terms.

Dividend payment tests

27. The payment of each Dividend is subject to the following Dividend Payment Tests:

- the Directors, at their absolute discretion, resolving to pay the Dividend on the relevant Dividend Payment Date; and
- no APRA condition existing in respect of the relevant Dividend Payment date. An APRA condition will exist in respect of a Dividend Payment if:
    - paying the Dividend on the CPS on the Dividend Payment Date would result in the Minimum Capital Requirement of the Group not complying with APRA's then current capital adequacy guidelines as they are applied to the Group at that time (unless APRA otherwise approves in writing);
    - the Dividend payment on the CPS on the Dividend Payment Date would exceed Distributable Profits as at the Record Date for the Dividend payment (unless APRA otherwise approves in writing);
    - paying the Dividend would result in IAG becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*; or
    - APRA objecting to the Dividend payment on the CPS on the payment date.

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

29. Dividends are non-cumulative and the CPS Holders will have no recourse in the event of non-payment arising because the Directors have not resolved to pay a Dividend, an APRA Condition exists at the relevant time or because of any applicable law. IAG has no liability, and CPS Holders have no claim or entitlement, in respect of such non-payment and such non-payment does not constitute an event of default by IAG.

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

Restrictions in the case of non-payment of Dividends

31. If, for any reason, a Dividend has not been paid in full on a Dividend Payment Date (the Relevant Dividend Payment Date), IAG must not, without the approval of a Special Resolution, until and including the next Dividend Payment Date:

- resolve to pay or pay a Dividend or make any distributions on any Ordinary Shares; or
- buy-back or reduce capital on any Ordinary Shares,

unless the Dividend is paid in full within three Business Days of the Relevant Dividend Payment Date. These restrictions in the case of non-payment of a Dividend are subject to the exceptions set out in clause 2.9 of the CPS Terms.

Mandatory Conversion

32. Subject to a Non-Viability Trigger Event, IAG must Convert all (but not some) CPS on issue to Ordinary Shares on the Mandatory Conversion Date.

33. The Scheduled Mandatory Conversion Date will be 1 May 2019, but Conversion will not occur on that date unless the Mandatory Conversion Conditions are satisfied. If any of those conditions are not satisfied on 1 May 2019, the CPS will Convert on the first Dividend Payment Date after 1 May 2019 (a Subsequent Mandatory Conversion Date) on which the Mandatory Conversion Conditions are satisfied.

34. The Mandatory Conversion Conditions for each Relevant Date (being the relevant Mandatory Conversion Date) are:

- First Mandatory Conversion Condition: the average of the daily volume weighted average sales price (VWAP) of Ordinary Shares on the First Test Date (being the 25th Business Day immediately preceding (but not including) the Relevant Date) is greater than the First Test Date Percentage which, as described in the Prospectus, is expected to be 57.5% of the Issue Date VWAP;
- Second Mandatory Conversion Condition: the VWAP of Ordinary Shares during the 'Second Test Period' (being the period of 20 Business Days on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Date) is greater than the Conversion Test Date Percentage which, as described in the Prospectus, is expected to be 50.51% of the Issue Date VWAP; and

- Third Mandatory Conversion Condition: no Delisting Event applies to Ordinary Shares in respect of the Relevant Date. That is:
  - Ordinary Shares have not ceased to be listed or admitted to trading on the ASX;
  - trading of Ordinary Shares on the ASX has not been suspended for a period of five consecutive Business Days prior to the Mandatory Conversion Date and including the Mandatory Conversion Date; or
  - no Inability Event subsists, meaning that IAG is not prevented by applicable law or order of any court or action of any government authority (including regarding the insolvency winding-up or other external administration of IAG) or any other reason from Converting the CPS.

35. The CPS must also be Converted if a Non-Viability Trigger Event occurs. A Non-Viability Trigger Event means APRA has provided a written determination to IAG that all (or some) of the CPS must be Converted as:

- without that Conversion, IAG would become, in APRA's opinion, non-viable; or
- there is to occur a public sector injection of capital into or equivalent capital support with respect to, IAG without which IAG would become, in APRA's opinion, non-viable.

36. Conversion following a Non-Viability Trigger Event is not subject to the Mandatory Conversion Conditions being satisfied.

Optional Exchange

37. IAG may, with APRA's prior written approval, by notice to CPS Holders elect in accordance with the CPS Terms to Exchange (via Conversion or Redemption or combination of both):

- all or some CPS on an Optional Exchange Date. Optional Exchange Date means the first Dividend Payment Date falling on or after the fifth anniversary of the Issue Date and any date after that date as specified in the Exchange Notice;
- all or some CPS on an Exchange Date following the occurrence of a Tax Event or a Regulatory Event; or
- all (but not some only) CPS on an Exchange Date following the occurrence of a Potential Acquisition Event.

38. If IAG elects to Exchange CPS in accordance with the CPS Terms, it must elect which of the following (or which combination of the following) it intends to do in respect of the CPS (the Exchange Method):

- Convert CPS into Ordinary Shares; or
- Redeem CPS for the Redemption Price.

39. IAG's right to elect to Redeem or Convert under the Exchange Method is subject to APRA's prior written approval and is restricted in circumstances described in clauses 5.3(b) and 5.4 of the CPS Terms.

40. CPS Holders do not have a right to request an Exchange.

Conversion

41. 'Conversion', in relation to a CPS, is the taking effect of the rights specified in clause 7 of the CPS Terms in relation to that CPS.

42. Upon Conversion (whether mandatory or at IAG's election), each CPS that is being Converted will convert into one Ordinary Share on the Mandatory Conversion Date, the Non-Viability Conversion Date, the Exchange Date, or the Acquisition Exchange Date (as the case may be).

43. Each CPS Holder will also be allotted, for no consideration, an additional number of Ordinary Shares for each CPS that is being Converted. The additional number of Ordinary Shares that will be allotted to the CPS Holder for each CPS that is being Converted will be equal to one less than the Conversion Number, where the Conversion Number is (subject to clause 7.12 of the CPS Terms and subject always to the Conversion Number being no more that the Maximum Conversion Number) a number calculated according to a formula set out in clause 7.1(b) of the CPS Terms.

44. The Maximum Conversion Number is a number calculated according to a formula set out in clause 7.1(b) of the CPS Terms.

45. The total market value of Ordinary Shares held by a CPS Holder immediately after the Conversion of a CPS (and as a result of such Conversion) is expected to approximate the Issue Price. However, this may not be the case if Conversion happens because of a Non-Viability Trigger Event and the Maximum Conversion Number applies.

46. Clause 7.1 of the CPS Terms states that Conversion does not constitute redemption, buy-back, cancellation or termination of CPS, or an issue, allotment or creation of a new Ordinary Share (other than any additional Ordinary Shares allotted under clause 7.1(b) of the CPS Terms).

Redemption

47. IAG may (subject to APRA giving written approval) elect to Redeem CPS in accordance with the CPS Terms. 'Redeem' means, in relation to a CPS, 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, in connection with that CPS in accordance with clause 8 of the CPS Terms.

48. CPS will be Redeemed by payment on the Exchange Date or the Acquisition Exchange Date (as the case may be), of the Redemption Price, being an amount equal to the Issue Price plus an amount payable under clause 8.3(a)(iii) of the CPS Terms, by way of redemption, buy-back, reduction of capital or any combination thereof to the CPS Holder.

49. The portion of the Redemption Price that is an amount payable under clause 8.3(a)(iii) of the CPS Terms is an amount equal to a Dividend calculated in accordance with clause 2 of the CPS Terms. This portion of the Redemption Price will only be payable if the Directors, in their absolute discretion, make a determination that the Redemption Price should include such an amount.

50. On the Exchange Date or the Acquisition Exchange Date (as the case may be), the only right a CPS Holder will have in respect of their CPS will be to obtain the Redemption Price. Upon payment of the Redemption Price, all other rights conferred, or restrictions imposed, by the CPS will no longer have effect.

Other matters

51. This Ruling is made on the basis that:

- the documents listed in paragraph 13 of this Ruling provide a complete and accurate description of the scheme;
- the documents listed in paragraph 13 of this Ruling are intended by the parties to have their legal effect, and the scheme will be implemented according to the terms of these documents;
- all parties to the scheme are dealing with each other on arm's length terms and fair value consideration will be provided by the CPS Holders to acquire CPS;
- each CPS is an 'equity interest' in IAG pursuant to Division 974 of the ITAA 1997;
- IAG will frank the Dividends paid on CPS at the same franking percentage as the benchmark for the franking period in which the payments are made;

- the share capital of IAG will not become ‘tainted’ (within the meaning of Subdivision 197-A of the ITAA 1997) by the issue of CPS or the allotment of additional Ordinary Shares on Conversion of CPS;
- the majority of the CPS Holders are expected to be residents of Australia for tax purposes, although some may be non-residents;
- CPS are expected to be treated as a liability for Australian International Financial Reporting Standards purposes;
- for the purposes of determining whether a CPS Holder is a ‘qualified person’ under former Division 1A of Part IIIAA of the ITAA 1936, the CPS Holder and their associates will not have any ‘positions’ (within the meaning of former section 160APHJ of the ITAA 1936) in relation to the CPS or an interest in the CPS apart from holding the CPS and will not make, or will not be under an obligation to make, a ‘related payment’ (within the meaning of former section 160APHN of the ITAA 1936) in relation to Dividends payable in respect of the CPS;
- the CPS Holders in receipt of Dividends on CPS will have held their CPS for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the CPS Holder has materially diminished risks of loss or opportunities for gain in respect of their CPS or an interest in their CPS), within the period beginning on the day after the day on which the CPS Holders acquired their CPS and ending on the 90th day after the day on which the CPS become ex-dividend;
- Dividends on CPS will be paid out of the retained profits of IAG and not sourced, directly or indirectly, from IAG’s share capital account;
- the dividend payout ratios or the franking credits in relation to the ordinary share capital or other preference share capital of IAG are not expected to materially change as a result of the issue of CPS;
- the issue of the CPS and subsequent Conversion should not materially influence IAG’s existing dividend policy in respect of its ordinary shares;
- on the date of Conversion of CPS into Ordinary Shares, the rights and obligations attached to those Ordinary Shares are the same as those contained in the Constitution of IAG; and
- an Ordinary Share issued under the relevant terms and conditions contained in the Constitution of IAG is properly characterised as an ‘equity interest’ in IAG under Division 974 of the ITAA 1997.

Ruling

Acquisition time of CPS

52. Under item 2 in the table in section 109-10 of the ITAA 1997, the CPS Holders will acquire the CPS on 1 May 2012, being the date the CPS will be issued to the CPS Holders.

CPS cost base and reduced cost base

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

Inclusion of Dividends in assessable income

54. Dividends paid to CPS Holders will meet the definition of 'dividend' in subsection 6(1) of the ITAA 1936.

55. A Dividend paid to a CPS Holder is a 'frankable distribution' within the meaning of section 202-40 of the ITAA 1997.

56. CPS Holders must include in their assessable income:

- all Dividends received in respect of their CPS (subparagraph 44(1)(a)(i) of the ITAA 1936); and
- an amount equal to the franking credit that is attached to Dividends received in respect of their CPS (subsection 207-20(1) of the ITAA 1997).

Entitlement to a tax offset

57. CPS Holders will be entitled to a tax offset equal to the franking credit that is attached to the Dividends received in respect of their CPS under subsection 207-20(2) of the ITAA 1997.

58. CPS Holders, who are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 in respect of the franking credits attached to the Dividends received, will also be subject to the refundable tax offset rules in Division 67 of the ITAA 1997 unless the CPS Holders or entities entitled to the tax offset are specifically excluded by the operation of section 67-25 of the ITAA 1997.

Gross-up and tax offset denied in certain circumstances

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

Credit to franking account for certain corporate tax entities

60. For a CPS Holder that is a 'franking entity' (within the meaning given in section 202-15 of the ITAA 1997) and is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the franking credit on a Dividend received by the CPS Holder, a credit of the franking credit on the Dividend will arise in the CPS Holder's franking account on the day the Dividend is made (item 3 of the table in subsection 205-15(1) of the ITAA 1997).

Imputation benefits

61. 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 CPS Holders in respect of CPS.

62. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by CPS Holders in relation to the Dividends payable in respect of CPS.

Conversion of each CPS and allotment of additional Ordinary Shares

63. The Conversion of each CPS into Ordinary Shares and the allotment of additional Ordinary Shares will not result in a CGT event happening (Division 104 of the ITAA 1997).

64. 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 or reduced cost base of each CPS over the Converted CPS and any additional Ordinary Shares allotted by IAG.

65. The additional Ordinary Shares are taken to have been acquired at the time the CPS were originally acquired by the CPS Holders, being 1 May 2012 (item 1 in the table in subsection 130-20(3) of the ITAA 1997).

66. The allotment of any additional Ordinary Shares on Conversion of the CPS does not constitute a 'dividend' under subsection 6(1) of the ITAA 1936 and is therefore not included in CPS Holders' assessable income under subsection 44(1) of the ITAA 1936.

67. The value of any additional Ordinary Shares issued on Conversion of the CPS will not be assessable as ordinary income to CPS Holders under subsection 6-5(2) of the ITAA 1997.

68. Section 45 of the ITAA 1936 will not apply to treat any additional Ordinary Shares acquired on Conversion of the CPS as an unfranked dividend paid by IAG.

69. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the additional Ordinary Shares allotted to CPS Holders on Conversion of the CPS.

70. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the additional Ordinary Shares allotted to CPS Holders on Conversion of the CPS.

Commissioner of Taxation
18 April 2012

Appendix 1 – Explanation

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 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 interest is issued or allotted (item 2 in the table in section 109-10 of the ITAA 1997).

72. The CPS will be issued on 1 May 2012. Accordingly, under item 2 in the table in section 109-10 of the ITAA 1997, the CPS are acquired on 1 May 2012.

CPS cost base and reduced cost base

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

74. The Issue Price of each CPS is $100. Accordingly, when 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. The definition of 'dividend' in subsection 6(1) of the ITAA 1936 provides that a dividend includes:

(a) any distribution made by a company to any of its shareholders, whether in money or other property; and

(b) any amount credited by a company to any of its shareholders as shareholders;

but does not include:

(a) moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection 6(4) of the ITAA 1936, does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property is debited against an amount standing to the credit of the share capital account of the company;

(b) moneys paid or credited, or property distributed, by a company for the redemption or cancellation of a redeemable preference share if:

(i) the company gives the holder of the share a notice when it redeems or cancels the share;

(ii) the notice specifies the amount paid-up on the share immediately before the cancellation or redemption; and

(iii) the amount is debited to the company's share capital account;

except to the extent that the amount of those moneys or the value of that property, as the case may be, is greater than the amount specified in the notice as the amount paid-up on the share; or

(c) a reversionary bonus on a life assurance policy.

76. Dividends paid to CPS Holders are expected to be paid in cash out of retained profits and not be sourced, directly or indirectly, from IAG's share capital account. The exclusions in paragraphs (d) to (f) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 do not apply.

77. Accordingly, Dividends paid to CPS Holders by IAG, a company, will meet the definition of 'dividend' in subsection 6(1) of the ITAA 1936.

78. 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.

79. Dividends paid in respect of CPS will be paid out of IAG's retained profits. Accordingly, CPS Holders must include the amount of the Dividends received by them in their assessable income.

80. Dividends paid in respect of the CPS are expected to be fully or substantially franked.

81. A Dividend payable by IAG in respect of the CPS (a share in the capital of IAG) will constitute a 'distribution' (within the meaning given in section 960-120 of the ITAA 1997). Section 202-30 of the ITAA 1997 provides that distributions and non-share dividends are frankable unless it is specified that they are unfrankable.

82. Section 202-40 of the ITAA 1997 provides that a distribution or a non-share dividend is a 'frankable distribution' if it is not unfrankable under section 202-45 of the ITAA 1997. Section 202-45 sets out the circumstances under which an amount or distribution is taken to be unfrankable. Based on the information provided by the Applicant, it is considered that none of those circumstances will apply to Dividends payable in respect of the CPS. Accordingly, Dividends payable in respect of the CPS will constitute frankable distributions under section 202-40 and will not be unfrankable under section 202-45.

83. Section 207-20 of the ITAA 1997 provides:

> (1) If an entity makes a *franked distribution to another entity, the assessable income of the receiving entity, for the income year in which the distribution is made, includes the amount of the *franking credit on the distribution. This is in addition to any other amount included in the receiving entity's assessable income in relation to the distribution under any other provision of this Act.
>
> (2) The receiving entity is entitled to a *tax offset for the income year in which the distribution is made. The tax offset is equal to the *franking credit on the distribution.

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

Entitlement to a tax offset

85. In accordance with subsection 207-20(2) of the ITAA 1997, a CPS Holder will be entitled to tax offset equal to the franking credit on the Dividends that has been included in their assessable income in the income year in which the Dividend is made.

86. CPS Holders who are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 in respect of the franking credit on the Dividends received in respect of their CPS will also be subject to the refundable tax offset rules unless the CPS Holders or entities entitled to the tax offset are specifically excluded under section 67-25 of the ITAA 1997.

87. Entities excluded under section 67-25 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.

Gross-up and tax offset denied in certain circumstances

88. 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.

89. Pursuant to subsection 207-145(1) of the ITAA 1997, a 'manipulation of the imputation system' may occur where a franked distribution is made to an entity in one or more of the following circumstances:

- the entity is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of former Part IIIA of the ITAA 1936 (paragraph 207-145(1)(a) of the ITAA 1997);

- the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(b) of the ITAA 1997);
- the Commissioner has made a determination under paragraph 204-30(3)(c) of the ITAA 1997 that no imputation benefit (within the meaning given by subsection 204-30(6) of the ITAA 1997) is to arise in respect of the distribution for the entity (paragraph 207-145(1)(c) of the ITAA 1997); or
- the dividend is made as part of a dividend stripping operation (within the meaning given by section 207-155 of the ITAA 1997) (paragraph 207-145(1)(d) of the ITAA 1997).

90. A person who has held shares or an interest in shares on which a dividend has been paid (the holder) is a 'qualified person' for the purposes of former Division 1A of Part IIIAA of the ITAA 1936 if, generally speaking, they satisfy the holding period rule and the related payments rule (see former section 160APHO of the ITAA 1936).

91. The holding period rule applies where neither the holder nor an associate of the holder has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend, 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).

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

93. A CPS Holder will be a 'qualified person' in relation to a Dividend received in respect of their CPS, provided that:

- the CPS Holder will have held their CPS at risk for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the CPS Holder has materially diminished risks of loss or opportunities for gain in respect of their CPS or an interest in their CPS) in the period beginning on the day after the day on which the CPS Holder acquired their CPS and ending on the 90th day after the day on which the CPS become ex-dividend (former subsections 160APHO(2) and 160APHO(3) and former sections 160APHM and 160APHJ of the ITAA 1936); and

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

94. If either, or both, of the above two considerations are not met, a CPS Holder will not be a 'qualified person' for the purposes of Division 1A of former 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 CPS Holder.

95. The Commissioner has confirmed that a determination under paragraph 177EA(5)(b) of the ITAA 1936 or a determination under paragraph 204-30(3)(c) of the ITAA 1997 will not be made to deny the imputation benefits attached to Dividends paid by IAG to the CPS Holders.

96. 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 making of the distribution arose out of, or was made in the course of, a scheme that was by way of, or in the nature of dividend stripping, or a scheme that had substantially the effect of a scheme that was by way of, or in the nature of, dividend stripping.

97. The documents listed in paragraph 13 of this Ruling provide no indication that the offering of CPS and the associated payment of franked Dividends to the CPS Holders in any way constitute a dividend stripping arrangement. As such, the dividend stripping provision will have no application to the CPS Holders.

Credit to franking account for certain corporate tax entities

98. Item 3 in the table in subsection 205-15(1) of the ITAA 1997 provides that a credit of the franking credit on a distribution made to an entity arises in the franking account of that entity on the day on which the distribution is made if:

- the distribution is a franked distribution;
- the entity satisfies the residency requirement for the income year in which the distribution is made;
- the entity is a 'franking entity' when it receives the distribution; and
- the entity is entitled to a tax offset under Division 207 of the ITAA 1997 because of the distribution.

99. Pursuant to section 202-15 of the ITAA 1997, an entity is a 'franking entity' at a particular time if:

- it is a corporate tax entity (within the meaning given by section 960-115 of the ITAA 1997) at that time;

- it is not a life insurance company that is a mutual insurance company at that time; and
- in a case where the entity is a company that is a trustee of a trust — it is not acting in its capacity as trustee of the trust at that time.

100. Accordingly, if a CPS Holder is a 'franking entity' and is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the franking credit on a Dividend received by the CPS Holder, a credit of the franking credit on the Dividend will arise in the CPS Holder's franking account on the day the Dividend is made.

Imputation benefits

Streaming of imputation benefits

101. Subdivision 204-D of the ITAA 1997 broadly enables the Commissioner to make a determination where distributions with attached imputation benefits are streamed to a member of a corporate tax entity in preference to another member.

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

- an 'imputation benefit' is, or apart from section 204-30 of the ITAA 1997 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); and
- the other member (disadvantaged member) of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c) of the ITAA 1997).

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

104. IAG has indicated that all CPS Holders will receive fully or substantially franked Dividends regardless of their tax attributes or their individual tax position. The dividend payout ratios or franking credits, in relation to the Ordinary Shares or other preference shares, will not be materially affected by the issue of CPS.

105. The additional Ordinary Shares allotted on Conversion of CPS will not attract the application of section 204-30 of the ITAA 1997. This is because the issue of the additional Ordinary Shares does not constitute a distribution, and the allotment of additional Ordinary Shares will not materially affect IAG's fully franked dividend policy.

106. Based on the information provided, the Commissioner has concluded that the requisite element of streaming does not exist in relation to the franked distributions to be paid by IAG to the CPS 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 CPS Holders.

General anti-avoidance provision

107. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies where one of the purposes (other than an incidental purpose) of the scheme is to obtain an imputation benefit. In these circumstances, subsection 177EA(5) of the ITAA 1936 enables the Commissioner to make a determination with the effect of either:

- imposing franking debits or exempting debits on the distributing entity's franking account; or
- denying the imputation benefit on the distribution that flowed directly or indirectly to the relevant taxpayer.

108. 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;

(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

(c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit;

(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.

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

(a) the issue of the CPS constitutes a scheme for the disposition of a membership interest (paragraph 177EA(3)(a) of the ITAA 1936);

(b) 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;

(c) the issuance of CPS on the terms set out in the Prospectus is a scheme that involves the issuing of membership interests because, once the CPS are issued, the CPS Holders are members of IAG and the CPS are not debt interests (sections 960-130 and 960-135 of the ITAA 1997);

(d) frankable distributions are expected to be payable to the CPS Holders (paragraph 177EA(3)(b) of the ITAA 1936). The Commissioner accepts that Dividends payable on IAG CPS will be frankable distributions to the extent that the Dividends on the CPS are not 'unfrankable' within the meaning of section 202-45 of the ITAA 1997;

(e) franked distributions are expected to be paid to the CPS Holders (paragraph 177EA(3)(c) of the ITAA 1936). It is expected that these distributions will be made twice a year. IAG has indicated that it intends to fully or substantially frank all frankable distributions made by it to the extent that franking credits are available in its franking account; and

(f) it is reasonable to expect that an imputation benefit will be received by the relevant taxpayers as a result of distributions made to the CPS Holders as IAG intends to fully or substantially frank the distributions on the CPS (paragraph 177EA(3)(d) of ITAA 1936).

110. 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.

111. 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.

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

113. The Commissioner considers that a number of the relevant circumstances of the present arrangement go some way towards indicating a non-incidental purpose of enabling a relevant taxpayer to obtain an imputation benefit. In particular:

- the calculation of the Dividend by reference to the corporate tax rate; and
- the obligation on IAG to gross-up any Dividend payable to CPS Holders to the extent to which the franking percentage of the Dividend is less than 100% by a factor that reflects the corporate tax rate;

would be matters going to paragraph 177EA(17)(f) of the ITAA 1936 and are of significance for the ascertainment of the relevant purpose (*Mills v. Commissioner of Taxation* [2011] FCAFC 158, per Jessup J, Dowsett J agreeing).

114. However, based on the information provided and the qualifications set out in this Ruling, the Commissioner's consideration of all of the relevant circumstances of the scheme would not, on balance, lead to a conclusion that the purpose of enabling CPS Holders to obtain imputation benefits is more than incidental to IAG's purpose of raising Tier 1 Capital as part of its capital management strategy within the guidelines prescribed by APRA (including to refinance the IAG RPS).

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

Conversion of each CPS and allotment of additional Ordinary Shares

CGT events

116. Under the CPS Terms, each CPS will convert into one Ordinary Share through a variation of the rights attaching to each CPS. The CPS Holders will also receive an allotment of additional Ordinary Shares in IAG.

117. 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 relevant CGT asset, being the share (Taxation Ruling TR 94/30).

118. 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).

119. The mere variation of rights attaching to the CPS and allotment of an additional number of Ordinary Shares for no consideration does not result in the ownership of an intangible asset coming to an end by the share being redeemed or cancelled under paragraph 104-25(1)(a) of the ITAA 1997.

120. Further, the Conversion of CPS to Ordinary Shares by the variation of the rights attaching to the CPS does not result in the ownership of an intangible asset coming to an end by the CPS being converted under paragraph 104-25(1)(f) of the ITAA 1997.

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

122. As CGT event C2 will not occur on Conversion of CPS into Ordinary Shares, Subdivision 130-C of the ITAA 1997 will have no application.

123. Although CGT event C2 does not happen because of the variation of the rights attaching to the CPS, the receipt of money or other consideration in respect of such a variation may attract the operation of CGT event H2 (paragraphs 9 and 46 to 48 of TR 94/30).

124. Subsection 104-155(1) of the ITAA 1997 provides that CGT event H2 happens if:

(a) an act, transaction or event occurs in relation to a CGT asset that you own; and

(b) the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

125. The Conversion of CPS involving the allotment of additional Ordinary Shares will result in an adjustment to the cost base and reduced cost base of the Converted CPS under Subdivision 130-A of the ITAA 1997 or section 6BA of the ITAA 1936.

126. Accordingly, CGT event H2 does not happen on the Conversion of the CPS involving the allotment of additional Ordinary Shares.

Cost base of additional Ordinary Shares

127. 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.

128. Pursuant to subsection 6BA(3) of the ITAA 1936, the additional Ordinary Shares are issued to the CPS Holders for no consideration and are not a dividend or taken to be a dividend, the Issue Price of the CPS will be apportioned over the Converted CPS and any additional Ordinary Shares allotted.

129. Further, Subdivision 130-A of the ITAA 1997 applies in a similar manner. It provides special rules relating to the time of acquisition and the cost base of bonus equities for CGT purposes.

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

131. Under item 1 in the table in subsection 130-20(3) of the ITAA 1997, where the additional Ordinary 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 is apportioned over both the Converted CPS and any additional Ordinary Shares issued to the CPS Holders by IAG.

Acquisition time of additional Ordinary Shares

132. Item 1 in the table in subsection 130-20(3) of the ITAA 1997 provides that if you acquire the original equities on or after 20 September 1985, you are taken to have acquired the bonus equities when you acquired the original equities.

133. Accordingly, the CPS Holders are taken to have acquired the additional Ordinary Shares at the time when the CPS were originally acquired by the CPS Holders, being 1 May 2012.

Allotment of additional Ordinary Shares – dividend

134. 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.

135. Although the additional Ordinary Shares issued on Conversion of CPS will constitute 'property' in the hands of the CPS Holders, the allotment is not a disposition of property in the ordinary meaning of that expression (*Ord Forrest Pty Ltd v. Federal Commissioner of Taxation* (1974) 130 CLR 124; 74 ATC 4034; (1974) 4 ATR 230. The allotment of shares does not involve any loss of value by, or outgoing or expenditure of resources of, the company.

136. As there is no disposition there cannot be a distribution of property by IAG.

137. Further, the allotment of additional Ordinary Shares does not constitute a dividend under subsection 6BA(5) of the ITAA 1936 as the Terms do not provide CPS Holders with a choice of being paid a dividend or being issued shares.

138. No amount is credited to the CPS Holders, nor is an amount paid out of profits.

139. Accordingly, the allotment of additional Ordinary Shares does not constitute a dividend within the meaning of subsection 6(1) of the ITAA 1936 and is, therefore, not included in assessable income under subsection 44(1) of the ITAA 1936.

Value of additional Ordinary Shares – ordinary income

140. Subsection 6-5(2) of the ITAA 1997 provides that an Australian resident's assessable income includes ordinary income derived from all sources during the income year. Ordinary income is income according to ordinary concepts.

141. The periodicity, regularity and recurrence of a receipt has been considered to be a hallmark of its character as income in accordance with the ordinary concepts and usages of mankind (*Federal Commissioner of Taxation v. Dixon* (1952) 86 CLR 540; (1952) 10 ATD 82, *Federal Commissioner of Taxation v. Myer Emporium Ltd* (1987) 163 CLR 199; 87 ATC 4363; (1987) 18 ATR 693).

142. The character of the receipt must be determined from the point of view of the recipient and not from the standpoint of the payer or some other person (*McLaurin v. Federal Commissioner of Taxation* (1961) 104 CLR 381; (1961) 12 ATD 273, *Scott v. Federal Commissioner of Taxation* (1966) 117 CLR 514; 14 ATD 286, *Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation* (1977) 34 FLR 375; 77 ATC 4255; (1977) 7 ATR 519).

143. The allotment of additional Ordinary Shares will be a bonus issue within the meaning of paragraph 254A(1)(a) of the Corporations Act. That is, an issue of shares for which consideration is not payable to IAG.

144. The total market value of Ordinary Shares held by a CPS Holder immediately after the Conversion of a CPS (and as a result of such Conversion) is expected to approximate the Issue Price (unless a Non-Viability Trigger Event happens and the Maximum Conversion Number applies).

145. The allocation of any additional Ordinary Shares on Conversion does not have the characteristics of income according to ordinary concepts but rather, will result in a re-expression of the CPS Holder's interest in the share capital of IAG.

146. Accordingly, the value of any additional Ordinary Shares issued on Conversion of the CPS will not be assessable as ordinary income under subsection 6-5(2) of the ITAA 1997.

Section 45 of the ITAA 1936

147. 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%.

148. IAG has consistently paid fully franked dividends and has stated its intention to continue paying fully or substantially franked dividends to all its shareholders, including the CPS Holders, to the extent of the franking credits available. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to treat any additional Ordinary Shares acquired on Conversion of the CPS as an unfranked dividend paid by IAG.

Section 45A of the ITAA 1936

149. Section 45A of the ITAA 1936 applies in respect of a company that streams the provision of capital benefits and the payment of dividends to its shareholders in such a way that certain shareholders (the advantaged shareholders) would, in the year of income in which the capital benefits are provided, derive a greater benefit from the capital benefits than other shareholders (the disadvantaged shareholders) and it is reasonable to assume that the disadvantaged shareholders have received, or will receive, dividends.

150. The allotment of additional Ordinary Shares to CPS Holders on Conversion of their CPS will constitute 'provision of a capital benefit' to a shareholder in IAG (paragraph 45A(3)(a) of the ITAA 1936).

151. The allotment of additional Ordinary Shares to CPS Holders on Conversion of their CPS will, in effect, be a restatement of the CPS Holders' interest in the capital of IAG. In the absence of any other factors that would contribute to an alternative conclusion, the allotment of additional Ordinary Shares on Conversion will not constitute the streaming of capital benefits.

152. Accordingly, it cannot be said that the CPS Holders would derive a greater benefit from capital benefits than other shareholders of IAG. Therefore, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the additional Ordinary Shares allotted to CPS Holders on Conversion of the CPS.

Section 45B of the ITAA 1936

153. Section 45B of the ITAA 1936 may apply where certain capital benefits are provided in substitution for dividends and the conditions contained in subsection 45B(2) of the ITAA 1936 are met.

154. The allotment of additional Ordinary Shares to CPS Holders on Conversion of the CPS will constitute a scheme under which the CPS Holders are 'provided with a capital benefit' by IAG (subsection 45B(5) of the ITAA 1936). However, section 45B of the ITAA 1936 will only apply if, having regard to the 'relevant circumstances' of the scheme, it would be concluded that a person who entered into or carried out the scheme or any part of the scheme did so for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936). An non-exhaustive list of 'relevant circumstances' of the scheme is provided in subsection 45B(8) of the ITAA 1936.

155. Having regard to the relevant circumstances surrounding the issue and Conversion of the CPS, it cannot be concluded that any of the parties to the scheme will enter into, or carry out, the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit. Therefore, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the additional Ordinary Shares allotted to CPS Holders on Conversion of the CPS.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/30; TR 2006/10

Subject references:

- acquisition dates
- capital gains tax
- CGT cost base
- conversion of securities
- dividend imputation
- dividend income
- dividend streaming arrangements
- franking tax offset
- preference shares

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 6(4)
- ITAA 1936 6BA
- ITAA 1936 6BA(3)
- ITAA 1936 6BA(5)
- ITAA 1936 44(1)
- ITAA 1936 44(1)(a)
- ITAA 1936 44(1)(a)(i)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(a)
- ITAA 1936 45B
- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(5)
- ITAA 1936 45B(8)
- ITAA 1936 45C
- ITAA 1936 160APHO
- ITAA 1936 160APHO(1)
- ITAA 1936 160APHO(1)(a)
- ITAA 1936 160APHO(2)
- ITAA 1936 160APHO(3)
- ITAA 1936 160APHJ
- ITAA 1936 160APHM
- ITAA 1936 160APHN
- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1936 177EA(3)(a)
- ITAA 1936 177EA(3)(b)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(5)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(17)
- ITAA 1997 6-5(2)
- ITAA 1997 6-20
- ITAA 1997 6-23
- ITAA 1997 Div 67
- ITAA 1997 67-25
- ITAA 1997 67-25(1C)
- ITAA 1997 67-25(1D)
- ITAA 1997 104-25
- ITAA 1997 104-25(1)(a)
- ITAA 1997 104-25(1)(f)
- ITAA 1997 104-155(1)
- ITAA 1997 108-5
- ITAA 1997 109-10
- ITAA 1997 110-25(2)
- ITAA 1997 110-25(2)(a)
- ITAA 1997 110-55(2)
- ITAA 1997 112-30
- ITAA 1997 Subdiv 130-A
- ITAA 1997 130-20
- ITAA 1997 130-20(3)
- ITAA 1997 Subdiv 130-C
- ITAA 1997 Subdiv 197-A
- ITAA 1997 202-15
- ITAA 1997 202-30
- ITAA 1997 202-40
- ITAA 1997 202-45
- ITAA 1997 Subdiv 204-D
- ITAA 1997 204-30
- ITAA 1997 204-30(1)(a)
- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 204-30(6)
- ITAA 1997 205-15(1)
- ITAA 1997 Div 207
- ITAA 1997 207-20
- ITAA 1997 207-20(1)
- ITAA 1997 207-20(2)
- ITAA 1997 Subdiv 207-F
- ITAA 1997 207-145
- ITAA 1997 207-145(1)
- ITAA 1997 207-145(1)(a)
- ITAA 1997 207-145(1)(b)
- ITAA 1997 207-145(1)(c)
- ITAA 1997 207-145(1)(d)
- ITAA 1997 207-155
- ITAA 1997 Div 230
- ITAA 1997 Div 974
- ITAA 1997 960-115
- ITAA 1997 960-120
- ITAA 1997 995-1(1)
- Copyright Act 1968

- Corporations Act 2001
- TAA 1953

Case references:

- Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation (1977) 34 FLR 375; 77 ATC 4255; (1977) 7 ATR 519
- Federal Commissioner of Taxation v. Dixon (1952) 86 CLR 540 (1952) 10 ATD 82
- Federal Commissioner of Taxation v. Myer Emporium Ltd (1987) 163 CLR 199; 87 ATC 4363; (1987) 18 ATR 693
- McLaurin v. Federal Commissioner of Taxation (1961) 104 CLR 381; (1961) 12 ATD 273
- Mills v. Commissioner of Taxation [2011] FCAFC 158
- Ord Forrest Pty Ltd v. Federal Commissioner of Taxation (1974) 130 CLR 124; 74 ATC 4034; (1974) 4 ATR 230
- Scott v. Federal Commissioner of Taxation (1966) 117 CLR 514; 14 ATD 286

Other references:

- Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002

ATO references

NO:	1-3PTMHCO
ISSN:	1445-2014
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 event – general