


# ***CR 2015/15 - Income tax: Yancoal SCN Limited: Subordinated Capital Notes***

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## Class Ruling

### Income tax: Yancoal SCN Limited: Subordinated Capital Notes

Contents	Para
<b>LEGALLY BINDING SECTION:</b>	
<b>What this Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>17</b>
<b>Scheme</b>	<b>18</b>
<b>Ruling</b>	<b>73</b>
<b>NOT LEGALLY BINDING SECTION:</b>	
<b>Appendix 1:</b>	
<b>Explanation</b>	<b>115</b>
<b>Appendix 2:</b>	
<b>Detailed contents list</b>	<b>325</b>

#### **① 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 considered in this Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
  - section 26BB of the ITAA 1936
  - subparagraph 44(1)(a)(ii) of the ITAA 1936
  - section 70B of the ITAA 1936
  - paragraph 128AAA(1)(c) of the ITAA 1936
  - subsection 128B(1) of the ITAA 1936
  - paragraph 128B(3)(ga) of the ITAA 1936
  - section 128D of the ITAA 1936
  - section 177EA 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
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-10 of the ITAA 1997
- section 104-25 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
- Subdivision 115-A of the ITAA 1997
- Subdivision 115-C of the ITAA 1997
- section 116-20 of the ITAA 1997
- Subdivision 130-C of the ITAA 1997
- subsection 202-40(2) of the ITAA 1997
- paragraph 204-30(3)(c) of the ITAA 1997
- subsection 207-20(1) of the ITAA 1997
- subsection 207-20(2) of the ITAA 1997
- Subdivision 207-E of the ITAA 1997
- section 207-145 of the ITAA 1997
- subsection 709-85(2) of the ITAA 1997
- Division 725 of the ITAA 1997
- section 775-45 of the ITAA 1997
- section 855-10 of the ITAA 1997
- subsection 960-50(6) of the ITAA 1997
- subsection 974-75(1) of the ITAA 1997, and
- section 974-120 of the ITAA 1997.

All subsequent references are to the ITAA 1997 unless otherwise indicated.

**Class of entities**

3. The class of entities to which this Ruling applies are investors (referred to in this Ruling as Noteholders) who, on 31 December 2014, acquired fully paid, unsecured, subordinated, perpetual, convertible notes issued by Yancoal SCN Limited (YSCNL) called Subordinated Capital Notes (SCN), and who:

- are either:
  - residents of Australia (within the meaning of subsection 6(1) of the ITAA 1936), or
  - foreign residents who pass the non-portfolio interest test under section 960-195, during the period in which they hold their SCN
- are not foreign residents who carry on a business in Australia at or through a permanent establishment in Australia
- do not hold their SCN as revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1)) – that is, they hold their SCN on capital account
- have an Australian functional currency for Australian tax purposes, and
- are not subject to the taxation of financial arrangements (TOFA) rules in Division 230 in relation to gains and losses on their SCN.

(Note – the TOFA rules in 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 Noteholders who acquired their SCN otherwise than by initial application under the Prospectus dated 24 November 2014 issued by YSCNL (to be read in conjunction with the Supplementary Prospectus and Second Supplementary Prospectus).

**Qualifications**

5. This Ruling does not deal with how the tax law applies to Noteholders who hold their SCN as revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1)).

6. This Ruling does not deal with how the tax law applies to Noteholders who are foreign residents who do not pass the non-portfolio interest test under section 960-195, during the period in which they hold their SCN.

7. This Ruling does not deal with how the tax law applies to Noteholders who are foreign residents who carry on a business in Australia at or through a permanent establishment in Australia.
8. This Ruling does not deal with how the tax law applies to Noteholders who do not have an Australian functional currency for Australian tax purposes.
9. This Ruling does not deal with how the tax law applies to Noteholders who are subject to the TOFA rules in Division 230 in relation to gains and losses on their SCN.
10. This Ruling does not consider how the tax law applies to Noteholders who acquire their SCN under a Resale Notice
11. This Ruling does not consider how the gross-up and tax offset rules in Division 207 apply to a Noteholder that is a partnership or the trustee of a trust, or to indirect distributions to partners in a partnership, or beneficiaries or trustees of a trust.
12. This ruling does not deal with how the tax law applies to YSCNL in relation to the issue of the SCN.
13. This ruling does not deal with how the tax law applies to Yancoal Australia Limited (YAL) in relation to the issue of the SCN.
14. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
15. 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 18 to 72 of this Ruling.
16. 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

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17. This Ruling applies from 31 December 2014 to 1 January 2045. The Ruling continues to apply after 1 January 2045 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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## Scheme

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

- Class Ruling application dated 13 January 2015
- Prospectus lodged with the Australian Securities and Investments Commission (ASIC) on 24 November 2014 (Prospectus)
- Supplementary Prospectus lodged with the ASIC on 12 December 2014
- Second Supplementary Prospectus lodged with the ASIC on 18 December 2014
- Terms of Issue of the SCN attached as Appendix A to the Prospectus (Terms of Issue)
- Unsecured Note Trust Deed released to the Australian Securities Exchange (ASX) on 24 November 2014 (Note Trust Deed), and
- Further particulars provided by the Applicant.

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

19. In this Class Ruling, unless otherwise defined, capitalised terms take the meaning that they have in the Terms of Issue.

### Relevant entities

#### **YAL**

20. YAL is an Australian resident company listed on the ASX.

21. YAL is the head company of the YAL income tax consolidated group (YAL Group).

22. YAL's principal business activity is to mine and export coal. YAL operates coal mines located in New South Wales and Queensland and holds mining, quarrying and prospecting rights in respect of those coal mines.

23. YAL's franking account balance at 31 December 2013 was approximately AU\$7.8 million.

## **YSCNL**

24. YSCNL is an Australian resident company.
25. YAL owns 100% of YSCNL shares on issue. YSCNL is a subsidiary member of the YAL Group.

## **The offer of SCN**

26. The obligations of YAL and YSCNL under the SCN are constituted by, and specified in, the Terms of Issue.
27. YSCNL is the Issuer of the SCN. The Issue Date of the SCN was 31 December 2014.
28. The SCN were offered to YAL shareholders as at 7.00pm on 28 November 2014, on a pro-rata basis of 2.32112 SCN for every 100 YAL Ordinary Shares held.
29. The SCN trade on the ASX under the ASX code of YCNPA.
30. Any entitlement to subscribe for SCN not taken up was allocated to shareholders who applied to take up more than their Entitlement. The shortfall then remaining was placed in a bookbuild and offered to the market on 23 December 2014.

## **Reasons for issuing the SCN**

31. The SCN were issued for the following reasons:
  - The offer of the SCN is a key part of a package of measures intended to strengthen YAL's balance sheet to alleviate covenant pressure under YAL's Bank of China Facilities and to improve its capacity to secure future funding for operation and growth opportunities as coal markets improve
  - YAL will apply US\$1.8 billion of the proceeds from the issue of the SCN to repay senior debt owing to Yanzhou Coal Mining Company Limited (Yanzhou) and use any remaining proceeds to part fund YAL's existing coal operations and future growth, and
  - The issue of the SCN, which are treated as equity for accounting purposes, and repayment of US\$1.8 billion of the senior debt owing to Yanzhou, reduces YAL's gearing, addresses its financial covenant position with its senior lenders (including the Bank of China), and establishes a more sustainable capital structure.

**Main features of the SCN**

32. Each of the SCN are issued fully paid with a face value of US\$100.
33. The SCN do not have a fixed maturity date and could remain on issue perpetually.

***Distribution calculation***

34. Subject to the Terms of Issue, each of the SCN carries an entitlement to be paid interest on its Face Value in respect of each Distribution Period from (and including) the Issue Date to (but excluding):
1. the last day of the Distribution Period immediately preceding its Conversion Date, or
  2. its Redemption Date.
35. A Distribution Period in respect of each of the SCN is defined as:
1. the period beginning on (and including) the Issue Date and ending on (but excluding) the first Distribution Payment Date, and
  2. thereafter, the period beginning on (and including) a Distribution Payment Date and ending on (but excluding) the first to occur of:
    - the next Distribution Payment Date, or
    - the Redemption Date.
36. A Distribution Payment Date in relation to each of the SCN, is the last Business Day of each January and July of each year, commencing on 31 July 2015 and falling on or before the Redemption Date.
37. The Distribution payable on each of the SCN in respect of any Distribution Period ending on a Distribution Payment Date is payable on that Distribution Payment Date and is the amount calculated in accordance with the following formula:
- $$\text{Distribution} = (\text{Distribution Rate} \times \text{US\$100})/2$$
- where:
- Distribution Rate** is the Distribution Rate on the first day of the Distribution Period.
38. If a Distribution Payment Date falls less than 5 Business Days prior to the Redemption Date then the Distribution that would otherwise be payable on that Distribution Payment Date will not be payable on that Distribution Payment Date but will instead be added to the Distribution payable under clause 3.2(c) on the Redemption Date.



39. The Distribution payable on each of the SCN in respect of the Distribution Period ending on its Redemption Date if the Redemption Date is not a Distribution Payment Date is payable on the Redemption Date as part of the Redemption Amount and is calculated according to the formula:

$$\text{Distribution} = (\text{Distribution Rate} \times \text{US\$100} \times N) / 365$$

where:

**Distribution Rate** is the Distribution Rate on the first day of the Distribution Period, and

**N** is the number of days in the Distribution Period.

40. The Distribution payable on each of the SCN in respect of the first Distribution Period is payable on the first Distribution Payment Date and is the amount calculated in accordance with the following formula:

$$\text{Distribution} = (\text{Distribution Rate} \times \text{US\$100} \times N) / 365$$

where:

**Distribution Rate** is the Distribution Rate on the Issue Date, and

**N** is the number of days in the Distribution Period.

41. A Distribution will not be payable on SCN in respect of any Distribution Period if the SCN are Converted before the date on which the Distribution for that Distribution Period is payable.

42. The Distribution Rate may be reset in accordance with clause 3 of the Terms of Issue.

### ***Distribution payment conditions***

43. YSCNL may, in its sole discretion, elect to defer payment of all or any part of the Distribution otherwise payable on the SCN on a Distribution Payment Date until such time as YSCNL elects to pay it or the SCN are required to be Redeemed. No additional Distribution or other amount is payable by YSCNL in respect of any Distribution deferred.

44. The term Unpaid Distribution Amount means the whole or any part of any Distribution that would otherwise have been payable on the SCN on a Distribution Payment Date which YSCNL has deferred, other than an amount which has been paid pursuant to an Optional Distribution Payment.

45. YSCNL has no obligation to pay any deferred amount of the Distribution except as part of the Redemption Amount of the SCN if the SCN are required to be Redeemed. However, YSCNL may in its discretion elect to pay such amount as an Optional Distribution Payment at any time.

46. YSCNL may not elect to defer payment of a Distribution that would otherwise be payable on a Distribution Payment Date if, since the Distribution Payment Date preceding that Distribution Payment Date (or in the case of the first Distribution Payment Date, since the Issue Date), YAL has undertaken a Restricted Action.

47. If any Distribution is not paid to the Noteholders in full on a Distribution Payment Date, then YSCNL must not, and must procure that YAL does not, undertake a Restricted Action until such time as the Unpaid Distribution Amount has been paid as an Optional Distribution Payment or all SCN have been Converted or Redeemed.

48. A Restricted Action is defined to mean:

1. a declaration, determination or payment of a dividend or distribution from the income or capital of YAL
2. a return of any capital or undertaking to buy-back or repurchase, or
3. a payment of any interest,

in relation to any Equal Ranking Obligations or Junior Ranking Obligations, other than:

4. pro-rata dividends, distributions or payments on Equal Ranking Obligations
5. any action taken in connection with an employment contract, employee share scheme, employee rights or option plan, or similar arrangement with, or for the benefit of, any one or more employees, officers, directors or consultants of YSCNL, YAL or their Related Bodies Corporate
6. any dividend, distribution, return of capital, buy-back, repurchase or payment only in the form of, or for a consideration provided by YAL only in the form of, or where any amount paid by YAL is mandatorily invested in, securities, warrants, options or other rights where the securities, or the securities issuable upon exercise of the warrants, options or other rights, constitute Equal Ranking Obligations (where the action relates to Equal Ranking Obligations) or Junior Ranking Obligations (in any case), or
7. any repayment or redemption of Equal Ranking Obligations or Junior Ranking Obligations which YAL is obliged to pay or undertake on the legal maturity date of such Equal Ranking Obligations or Junior Ranking Obligations.

## **Conversion**

49. Subject to clause 4 of the Terms of Issue, a Noteholder may request Conversion of the SCN held by it by giving a Conversion Notice to YSCNL and YAL at any time during the period commencing on the day falling 40 days after the Issue Date and ending on the date which falls 30 years from the Issue Date (Conversion Period).

50. Conversion may be requested in relation to some or all of the Noteholder's SCN, subject to the aggregate Face Value of the SCN the subject of the Conversion Notice being at least the lesser of US\$5,000 or the balance of the Noteholder's holding of SCN.

51. The conversion process on the Conversion Date where SCN are to be Converted under the Terms of Issue is as follows:

1. YSCNL will redeem the SCN for their Face Value, and apply the whole of that amount as payment to YAL by way of subscription by the Noteholder of the SCN for the number of new YAL Ordinary Shares to be issued to the Noteholder calculated in accordance with clause 4.3 of the Terms of Issue, and
2. YSCNL must cause to be issued to the relevant Noteholder the number of YAL Ordinary Shares calculated in accordance with clause 4.3 of the Terms of Issue.

52. The number of YAL Ordinary Shares issued on Conversion will be subject to clauses 4.3 to 4.8 of the Terms of Issue.

## **Redemption**

53. Redemption is defined to mean the redemption of any of the SCN, other than in connection with its Conversion by payment of its Redemption Amount in accordance with the Terms of Issue.

### *Redemption on Winding Up*

54. If an order is made by a court of competent jurisdiction, or an effective resolution is passed, for the Winding Up of YSCNL or YAL, YSCNL must Redeem each Subordinated Capital Note for its Redemption Amount.

### *Redemption at the option of YSCNL*

55. YSCNL may elect to Redeem all or some of the SCN on the First Reset Date or any Distribution Payment Date thereafter at their Redemption Amount.

56. YSCNL may elect to Redeem some but not all of the SCN on a pro-rata basis in respect of all Noteholders' SCN on issue at the relevant time.

*Redemption – Redemption event*

57. YSCNL may Redeem all (but not some) of the SCN for their Redemption Amount if one of the following events occurs:

- a Tax Event
- an Accounting Event, or
- a Change of Control Event.

*Redemption – clean up option*

58. If at any time the aggregate principal amount of the SCN outstanding is less than 10% of the aggregate principal amount of the SCN originally issued, YSCNL may Redeem all (but not some) of the SCN that remain outstanding for their Redemption Amount.

*Redemption Amount*

59. The Redemption Amount in respect of any of the SCN to be Redeemed, is the aggregate of:

1. the Face Value of the SCN, and
2. the aggregate of any accrued (but unpaid) Distributions up to but not including the Redemption Date and any Unpaid Distribution Amounts in respect of the SCN.

60. However, where Redemption is required due to a Winding Up of YSCNL or YAL, then accrued (but unpaid) Distributions and Unpaid Distribution Amounts will only be included in the calculation of the Redemption Amount to the extent that funds would be available to YSCNL to meet such payments after the discharge of all other debts of YSCNL.

***Resale***

61. YSCNL may elect that Resale occur in relation to all or some (subject to receiving the consent of any Noteholder whose SCN are not to be subject to the Resale) of the SCN on any date (the Resale Date) that YSCNL would be entitled to nominate as a Redemption Date for the SCN.

62. Any Noteholder whose SCN are the subject of a Resale Notice may elect that their SCN will not be subject to the Resale. If no notice of such an election is made by the Noteholder to YSCNL then the Noteholder is taken to have irrevocably offered to sell the relevant number of SCN to the Purchaser.

63. The Purchaser may be one or more third parties selected by YSCNL in its absolute discretion.

64. Upon Resale, the Noteholder will receive the Purchase Price from the Purchaser. All right, title and interest to the relevant SCN, the subject of the Resale, will transfer to the Purchaser.

65. Purchase Price, in respect of any Resale of SCN, is an amount equal to the Redemption Amount that would be payable in respect of the SCN if the SCN were being Redeemed on the Resale Date.

## ***Purchase***

66. YSCNL, YAL and any of YAL's other subsidiaries may at any time purchase SCN in the open market or otherwise and at any price. SCN so purchased may be held, resold or cancelled at the discretion of the purchaser (and, if the SCN are to be cancelled, YSCNL) subject to compliance with any applicable law or requirement of the ASX.

## ***Cancellation***

67. SCN Redeemed or purchased by YAL, YSCNL or another Subsidiary of YAL which the purchaser and YSCNL elect to cancel, will be cancelled by YSCNL and may not be resold.

## ***Payments***

68. Unless a Noteholder elects to receive payments in respect of its SCN in US dollars, YSCNL will use the amount payable in US dollars to purchase Australian dollars from an Australian financial institution at the exchange rate quoted to YSCNL by that financial institution and pay the amount received in Australian dollars (after deducting any fees, charges or commissions) to the Noteholder.

69. YSCNL may deduct from any Distribution or other amount payable to a Noteholder the amount of any withholding or other tax, duty or levy required by law to be deducted in respect of such amount.

## ***No other rights***

70. The SCN confer no rights on a Noteholder:

- (a) to vote at any meeting of shareholders of YSCNL or YAL
- (b) to subscribe for new securities or to participate in any bonus issues of securities of YSCNL or YAL, or
- (c) to otherwise participate in the profits or property of YSCNL or YAL, except as set out in the Terms of Issue or the Note Trust Deed.

71. A Trustee (the Note Trustee) has been appointed pursuant to the Note Trust Deed. The Note Trust Deed provides for the obligations of YAL, YSCNL and the Note Trustee to Noteholders in relation to the SCN and the Subordinated Guarantee. All rights in relation to the SCN and the Subordinated Guarantee may generally only be enforced by the Note Trustee in accordance with the Note Trust Deed.

### **Other matters**

72. This Ruling is made on the basis that:

- (a) YAL has not historically paid franked dividends and does not anticipate having sufficient franking credits to frank payments of Distributions on the SCN in the next three to five years.
- (b) All SCN are issued at market value.
- (c) Distributions in respect of the SCN will not be debited to YSCNL's 'share capital account' (as defined by section 975-300) or 'non-share capital account' (as defined by section 164-10).
- (d) On Conversion of the SCN, YSCNL will debit an amount (calculated under the Conversion formula in the Terms of Issue) to its 'non-share capital account'.
- (e) At the time of Conversion of the SCN, Yanzhou will hold the majority of both the SCN and YAL Ordinary Shares on issue.
- (f) The Noteholders do not have any tax losses or capital losses or any other tax attributes that would influence the dividend or Distribution policy of YSCNL or YAL.
- (g) There will not be a contract entered into to redeem the SCN.
- (h) Any Redemption of the SCN by YSCNL for cash will be effected by a debit to its 'non-share capital account' to the extent of the subscription price paid for the SCN.
- (i) Any Unpaid Distribution Amount on the SCN that are payable by YSCNL in cash on Redemption will not be effected by way of a debit against the company's 'non-share capital account' (as defined in section 164-10) or the company's 'share capital account' (as defined in section 975-300).
- (j) Distributions paid by YSCNL on the SCN will not be unfrankable distributions under section 202-45.
- (k) Any disposals of the SCN by Noteholders will be at market value.

- (l) Where a Redemption Notice is issued, all Noteholders will have held their SCN for a continuous period of at least 90 days (excluding the day of their acquisition and disposal) during the period beginning the day after the acquisition of the SCN such that the requirements of former subsection 160APHO(2) of the ITAA 1936 are satisfied.
- (m) Where a Distribution is paid in relation to the SCN other than as a result of a Redemption, all Noteholders will have held their SCN for a continuous period of at least 90 days (excluding the day of their acquisition and disposal) during the period beginning on the day after the acquisition of the SCN such that the requirements of former subsection 160APHO(2) of the ITAA 1936 are satisfied.
- (n) For the purposes of determining whether a Noteholder is a 'qualified person' in relation to Distributions under Division 1A of former Part IIIAA of the ITAA 1936, neither the Noteholder nor an associate of the Noteholder will take any 'position' (within the meaning of former section 160APHJ of the ITAA 1936) in relation to the SCN (apart from holding the SCN), and consequently will not have any days where they have a materially diminished risk of loss or opportunities for gain in respect of the SCN.
- (o) A Noteholder, or an associate of a Noteholder, will not make, is not under an obligation to make, or is not likely to make, a related payment (within the meaning of former section 160APHN of the ITAA 1936) in respect of any Distributions paid in respect of the SCN.
- (p) YSCNL is registered as a company in Australia (and is a resident of Australia within the meaning of subsection 6(1) of the ITAA 1936).
- (q) YSCNL is not a non-profit company as defined in the *Income Tax Rates Act 1986*.
- (r) YSCNL is not exempt from income tax for any reason.
- (s) YSCNL has not issued any kind of equity interest or debt interest (as defined in Division 974) other than the SCN and the Ordinary Shares held by YAL.
- (t) No member of the YAL Group will acquire SCN.
- (u) The SCN are an 'equity interest' in YSCNL under Division 974.
- (v) The SCN do not constitute a 'membership interest' (as defined in section 960-135) in YSCNL.
- (w) YSCNL will not differentially frank Distributions to different Noteholders in respect of the SCN according to the tax status of Noteholders or on any other basis.

- (x) Where YSCNL franks Distributions on the SCN, YAL (as the head company of the YAL Group of which YSCNL is a subsidiary member) is expected to frank each Distribution in respect of the SCN (being a 'frankable distribution') in accordance with its franking policy that applies to YAL Ordinary Shares (at such a time as Distributions are made), and in a manner that satisfies the benchmark rule in Division 203 for the franking period in which a frankable distribution is made.
- (y) The policy of YAL (as the head company of the YAL Group of which YSCNL is a subsidiary member) in relation to the franking of dividends on YAL Ordinary Shares is not expected to change as a result of the issuance of the SCN.
- (z) The allotment of YAL Ordinary Shares on Conversion of the SCN is not expected to affect YAL's dividend franking policy.
- (aa) Foreign residents will not be precluded from participating in the Offer, where the Offer is made in accordance with the laws of their jurisdiction.
- (bb) The YAL Ordinary Shares obtained by a Noteholder on Conversion of the SCN will be an 'equity interest' in YAL under Division 974.

## **Ruling**

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### **Issuance of the SCN**

#### ***Acquisition time of the SCN***

73. Noteholders are taken to have acquired their SCN on 31 December 2014, being the date on which the contract for the issue or allotment of the SCN was entered into (item 2 of the table in section 109-10).

#### ***Cost base and reduced cost base of the SCN***

74. The first element of the cost base and reduced cost base of each of the SCN will be US\$100, being the money paid by a Noteholder to acquire each of the SCN from YSCNL (subsections 110-25(2) and 110-55(2)).

75. When determining the cost base and reduced cost base of the SCN under subsections 110-25(2) and 110-55(2), the US dollar amount paid by a Noteholder to acquire the SCN will be translated to Australian currency at the exchange rate applicable on 31 December 2014, being the Issue Date of the SCN (item 5 of the table in subsection 960-50(6)).



## ***No direct value shift***

76. The issuance of the SCN did not cause a direct value shift (Division 725).

## **Inclusion of Distributions and franking credits in assessable income**

### ***General***

#### ***Non-share dividends***

77. A Distribution paid by YSCNL in respect of the SCN will be a non-share dividend (section 974-120).

#### ***Frankable distribution***

78. A Distribution paid by YSCNL in respect of the SCN is a 'frankable distribution' (subsection 202-40(2)).

79. Part 3-6 will operate as if the Distributions paid in respect of the SCN are a frankable distribution made by YAL as the head company of the YAL Group to a member of YAL (subsection 709-85(2)).

#### ***No forex realisation gain or loss on receipt of Distributions***

80. Forex realisation event 2 will happen to a Noteholder when they receive a Distribution from YSCNL in respect of the SCN (section 775-45). There will be no forex realisation gain or forex realisation loss from forex realisation event 2 happening when the US dollar denominated Distribution is received by a Noteholder.

#### ***Each of the SCN will not be a traditional security***

81. The SCN are not a 'traditional security' as defined in subsection 26BB(1) of the ITAA 1936.

82. A gain on the disposal or Redemption of the SCN will not give rise to assessable income for a Noteholder under section 26BB of the ITAA 1936. A loss on the disposal or Redemption of the SCN will not give rise to an allowable deduction for a Noteholder under section 70B of the ITAA 1936.

## ***Residents***

### ***Inclusion of Distributions in assessable income***

83. A Distribution (being a non-share dividend) paid by YSCNL in respect of the SCN will be included in an Australian resident Noteholder's assessable income (subparagraph 44(1)(a)(ii) of the ITAA 1936).

84. When determining their assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936, Australian resident Noteholders:

- who determine their assessable income on a receipts basis must translate the US dollar denominated Distribution to Australian currency at the exchange rate applicable at the time of receipt, or
- who do not determine their assessable income on a receipts basis must translate the US dollar denominated Distribution to Australian currency at the exchange rate applicable at the time when the requirement first arose to include it in the recipient's assessable income (item 7 of the table in subsection 960-50(6)).

*Inclusion of franking credits in assessable income*

85. The amount of any franking credit on a Distribution received by an Australian resident Noteholder must also be included in that Noteholder's assessable income for the income year in which they receive the Distribution (subsection 207-20(1)).

*Entitlement to a franking credit tax offset*

86. Australian resident Noteholders are entitled to a tax offset equal to any franking credit on the Distributions (subsection 207-20(2)) unless the Distribution is exempt income or non-assessable non-exempt income in the hands of the Noteholder and none of the exceptions in Subdivision 207-E apply.

*Franking credit subject to the refundable tax offset rules*

87. Australian resident Noteholders who are entitled to a franking credit tax offset (subsection 207-20(2)) in respect of the franking credit on the Distributions will be subject to the refundable tax offset rules in Division 67, unless they are specifically excluded under section 67-25.

*Section 177EA of the ITAA 1936*

88. 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 the Noteholders in respect of the Distributions paid on the SCN.

## *Imputation benefits – streaming*

89. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits received by the Noteholders in respect of the Distributions paid on the SCN.

## *Gross-up and tax offset*

90. Section 207-145 will not apply to the Distributions paid to the Noteholders in respect of the SCN, provided that a Noteholder is a 'qualified person' in relation to each Distribution. Accordingly, section 207-145 will not adjust the Noteholders' assessable income to exclude the amount of the franking credit on the Distributions, nor will it deny the tax offset to which the Noteholders would otherwise be entitled.

## ***Foreign residents***

### *Liability to withholding tax*

91. A liability to withholding tax will arise under subsection 128B(1) and paragraph 128AAA(1)(c) of the ITAA 1936 to the extent a Distribution paid by YSCNL in respect of the SCN is derived by a non-resident, but only applies to the part of the Distribution that is unfranked (paragraph 128B(3)(ga) of the ITAA 1936).

### *No further income tax liability*

92. Non-resident Noteholders who receive a Distribution in respect of the SCN are not required to include the Distribution in their assessable income (section 128D of the ITAA 1936).

## **Disposal of SCN**

### ***Disposal of the SCN – CGT implications***

93. CGT event A1 will happen to a Noteholder when they dispose of some or all of their SCN (section 104-10).

### ***Capital proceeds***

94. The capital proceeds received by a Noteholder from the disposal of their SCN will be equal to the money, and the market value of any other property, received or entitled to be received in respect of the disposal happening (section 116-20).

***Eligibility to be a discount capital gain***

95. Where a capital gain is made by an Australian resident Noteholder on the disposal of their SCN, it will be eligible to be a discount capital gain where the requirements of Subdivision 115-A (and, if applicable, Subdivision 115-C) are satisfied.

***Capital gain made by foreign resident Noteholders to be disregarded***

96. Where a capital gain is made by a foreign resident Noteholder on the disposal of their SCN, the capital gain will be disregarded (section 855-10).

**Conversion of SCN*****Each of the SCN are a convertible interest***

97. Each of the SCN are a 'convertible interest' in YSCNL (as defined in subsection 995-1(1) and item 4 of the table in subsection 974-75(1)). The Conversion of the SCN into YAL Ordinary Shares will be the conversion of a convertible interest.

***CGT event C2***

98. CGT event C2 will happen for the Noteholders on the Conversion of the SCN (section 104-25).

99. Any capital gain or capital loss made by the Noteholders from CGT event C2 happening on Conversion of the SCN will be disregarded (subsection 130-60(3)).

***Cost base and reduced cost base of YAL Ordinary Shares acquired on Conversion***

100. On Conversion of the SCN, the first element of the cost base and the reduced cost base of the YAL Ordinary Shares acquired on Conversion will be the cost base of the SCN at the time of Conversion (which will be the Conversion Date) divided by the number of YAL Ordinary Shares acquired (item 2 of the table in subsection 130-60(1)).

***Acquisition time of YAL Ordinary Shares on Conversion***

101. The YAL Ordinary Shares acquired by the Noteholders on Conversion of the SCN (being convertible interests) will be taken to have been acquired when the Conversion happens on the relevant Conversion Date (subsection 130-60(2)).

## ***Conversion of the SCN into YAL Ordinary Shares not a dividend***

102. The issue of YAL Ordinary Shares on Conversion of the SCN does not constitute a dividend as defined in subsection 6(1) of the ITAA 1936.

## ***Conversion of the SCN into YAL Ordinary Shares not a non-share dividend***

103. The issue of YAL Ordinary Shares on Conversion of the SCN does not constitute a non-share dividend as defined in section 974-120.

## ***No direct value shift***

104. The Conversion of the SCN will not cause a direct value shift (Division 725).

## **Redemption of SCN**

### ***CGT event C2***

105. CGT event C2 will happen for the Noteholders on the Redemption of the SCN (section 104-25).

106. The time of CGT event C2 will be the date on which the SCN are Redeemed by YSCNL (paragraph 104-25(2)(b)).

## ***Capital proceeds***

107. The capital proceeds received by the Noteholders from the Redemption of the SCN will be equal to the Face Value of each of the SCN, being the money received or entitled to be received in respect of the Redemption happening (section 116-20).

108. When determining the capital proceeds under section 116-20, the US dollar amount received by a Noteholder from the Redemption of the SCN will be translated to Australian currency at the exchange rate applicable on the Redemption Date of the SCN (item 5 of the table in subsection 960-50(6)).

## ***Eligibility to be a discount capital gain***

109. Where a capital gain is made by an Australian resident Noteholder on the Redemption of their SCN, it will be eligible to be a discount capital gain where the requirements of Subdivision 115-A (and, if applicable, Subdivision 115-C) are satisfied.

***Capital gain made by foreign resident Noteholders to be disregarded***

110. Where a capital gain is made by a foreign resident Noteholder on the Redemption of their SCN, the capital gain will be disregarded (section 855-10).

***No forex realisation gain or loss on receipt of the Face Value***

111. Forex realisation event 2 will happen to a Noteholder when they receive the amount of the Face Value from YSCNL in respect of the Redemption of the SCN (section 775-45). There will be no forex realisation gain or forex realisation loss from forex realisation event 2 happening when the US dollar denominated Face Value is received by a Noteholder.

**Anti-avoidance provisions on Conversion and Redemption*****Section 45 of the ITAA 1936***

112. Section 45 of the ITAA 1936 will not apply to treat the value of the YAL Ordinary Shares issued to the Noteholders on the Conversion of the SCN, or any part of the Redemption Amount paid to the Noteholders on the Redemption of the SCN, as an unfrankable dividend paid by YSCNL or YAL to the Noteholders.

***Section 45A of the ITAA 1936***

113. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or any part, of the capital benefit provided to the Noteholders on the Conversion or the Redemption of the SCN as an unfranked dividend paid by YSCNL or YAL to the Noteholders.

***Section 45B of the ITAA 1936***

114. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or any part, of the capital benefit provided to the Noteholders on the Conversion or the Redemption of the SCN as an unfranked dividend paid by YSCNL or YAL to the Noteholders.

## 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.*

### **Issuance of the SCN**

#### ***Acquisition time of the SCN***

115. An equity interest that is issued or allotted by a company is acquired when the contract is entered into or, if there is no contract, when the equity interests are issued or allotted (item 2 of the table in section 109-10).

116. The SCN are equity interests in YSCNL. Under item 2 of the table in section 109-10, a Noteholder will acquire their SCN on 31 December 2014, being the date on which the contract for the issue or allotment of the SCN was entered into.

#### ***Cost base and reduced cost base of the SCN***

117. The first element of the cost base and reduced cost base of a CGT asset (such as the SCN) includes the money paid in respect of acquiring the CGT asset (paragraph 110-25(2)(a) and subsection 110-55(2)).

118. The Issue Price of each of the SCN is US\$100. Accordingly, when the SCN were issued, the first element of the cost base and reduced cost base of each of the SCN is US\$100.

119. The SCN are denominated in US dollars. Subsection 960-50(1) requires an amount in a foreign currency to be translated into Australian currency for the purposes of the ITAA 1997. The relevant amounts are translated from the foreign currency into Australian currency under the general translation rules set out in the table in subsection 960-50(6).

120. The Noteholders acquired the SCN on 31 December 2014. In determining the cost base and reduced cost base of the SCN under subsections 110-25(2) and 110-55(2), item 5 of the table in subsection 960-50(6) requires the Issue Price of the SCN, which was paid in US dollars, to be translated to Australian currency at the exchange rate applicable on 31 December 2014.

#### ***No direct value shift***

121. Division 725 may apply where there is a direct value shift under a scheme involving equity interests in an entity. For Division 725 to apply, paragraph 725-145(1)(a) requires there to be a decrease in the market value of one or more equity or loan interests in the target entity.

122. Based on the facts and circumstances of this scheme, there is no decrease in the market value of one or more equity or loan interests in the target entity. Therefore, the issuance of the SCN did not cause a direct value shift under Division 725.

### **Inclusion of Distributions and franking credits in assessable income**

#### ***General***

##### *Non-share dividends*

123. Under subsection 974-120(1), subject to subsection 974-120(2), all non-share distributions are non-share dividends.

124. Subsection 995-1(1) states that the term 'non-share distribution' has the meaning given by section 974-115.

125. Section 974-115 states that a company makes a non-share distribution to you if:

- (a) you hold a non-share equity interest in the company, and
- (b) the company distributes money or other property to you, or credits an amount to you, as the holder of that non-share equity interest.

126. Subsection 995-1(1) provides that the term 'non-share equity interest' in a company means an equity interest in the company (as provided by Subdivision 974-C) that is not solely a share.

127. Subsection 995-1(1) defines a share in a company to mean a share in the capital of the company, and includes stock.

128. This Ruling is provided on the basis that the SCN held by Noteholders represent an equity interest in YSCNL in accordance with Division 974. The SCN do not represent a share in the capital of YSCNL or stock, and therefore are not solely a share. As such, the SCN represent a non-share equity interest in YSCNL held by Noteholders.

129. Distributions paid to the Noteholders as the holders of the non-share equity interests in YSCNL under the terms of the SCN will therefore represent non-share distributions under section 974-115. Consequently, the Distributions paid by YSCNL in respect of the SCN will give rise to a non-share dividend under subsection 974-120(1).

130. However, subsection 974-120(2) provides that a non-share distribution is not a non-share dividend to the extent to which the company debits the distribution against the company's non-share capital account or share capital account.

131. YSCNL will not debit the Distributions to its non-share capital account or share capital account. Therefore, subsection 974-120(2) will not apply and the Distributions paid by YSCNL in respect of the SCN will be non-share dividends.



## *Frankable distribution*

132. Subsection 202-40(2) provides that a non-share dividend is a frankable distribution, to the extent that it is not unfrankable under section 202-45.

133. The Distributions paid on the SCN are non-share dividends.

134. This Ruling is made on the basis that the Distributions paid on the SCN are not 'unfrankable distributions' under section 202-45.

135. Therefore, Distributions paid on the SCN are frankable distributions under subsection 202-40(2) and are not prevented from being franked by paragraph 202-5(b). Where paragraphs (a) and (c) of section 202-5 are also satisfied in relation to a Distribution, that Distribution will be taken to have been franked under section 202-5.

## Distributions taken to be made by YAL

136. Subsection 709-85(2) provides that Part 3-6 operates as if a distribution were a frankable distribution made by the head company of the group to a member of the head company, where subsection 709-85(1) is satisfied in relation to the distribution.

137. Subsection 709-85(1) provides that subsection 709-85(2) will operate where:

- (a) an entity holds a non-share equity interest in a subsidiary member of a consolidated group, and
- (b) the subsidiary member makes a non-share distribution to the entity as holder of the interest, and
- (c) the distribution is a frankable distribution, and
- (d) the entity to which the distribution is made is not a member of the group.

138. Noteholders are entities that hold SCN. The SCN represent a non-share equity interest in YSCNL. YSCNL is a subsidiary member of the YAL Group. Paragraph (a) is satisfied.

139. Distributions made to Noteholders will be made to them as a holder of the SCN. Distributions paid on the SCN will be non-share distributions. Paragraph (b) is satisfied.

140. Distributions on the SCN will be frankable distributions. Paragraph (c) is satisfied.

141. This Ruling is made on the basis that no members of the YAL Group will acquire the SCN. Therefore, no member of the YAL Group will receive Distributions as a holder of the SCN. Paragraph (d) is satisfied.

142. Given that the requirements of subsection 709-85(1) are satisfied in relation to Distributions on the SCN, subsection 709-85(2) causes Part 3-6 to operate as if Distributions on the SCN were a frankable distribution made by YAL as the head company of the YAL Group to a member of YAL.

*No forex realisation gain or loss on receipt of Distributions*

143. Subsection 775-45(1) states that forex realisation event 2 will happen if:

- (a) you cease to have a right, or part of a right to receive foreign currency, and
- (b) the right, or part of the right, is one of the following:
  - (i) a right, or part of a right, to receive, or that represents, ordinary income or statutory income (other than statutory income that is assessable under this Division or Division 102)..., and
- (c) you did not cease to have a right, or the part of the right, because you disposed of the right or the part of the right (within the meaning of section 775-40).

144. Subsection 775-45(2) provides that forex realisation event 2 happens when you cease to have the right or the part of the right.

145. The Distributions on the SCN paid by YSCNL are paid in US dollars. When YSCNL pays a Distribution, the Noteholder will have a right to receive foreign currency that represents ordinary or statutory income pursuant to subparagraph 775-45(1)(b)(i).

146. Upon the receipt of a US dollar Distribution, forex realisation event 2 will happen as the Noteholder will cease to have a right to receive foreign currency (paragraph 775-45(1)(a)).

147. The Noteholders did not cease to have the right to the US dollar Distribution because they disposed of it (subsection 775-45(1)(c)).

148. As the conditions in subsection 775-45(1) have been met forex realisation event 2 will happen to a Noteholder when they receive a Distribution from YSCNL in respect of the SCN (subsection 775-45(2))

149. In order for a forex realisation gain or loss to be made under forex realisation event 2 it is necessary that some or all of the excess or shortfall is attributable to a 'currency exchange rate effect' as defined under section 775-105 (paragraphs 775-45(3)(b) and 775-45(4)(b)).

150. As a Noteholders right to receive foreign currency will arise at the same time that it ceases to have the right (when it receives the US dollar denominated Distribution), there will be no 'currency exchange rate effect' as defined under section 775-105. Therefore, there will be no forex realisation gain or forex realisation loss upon forex realisation event 2 happening when the US dollar denominated Distribution is received by the Noteholder.

*Each of the SCN will not be a traditional security*

151. Where a taxpayer makes a gain or loss in relation to the disposal or redemption of a traditional security, section 26BB of the ITAA 1936 operates to include the amount of any gain in the assessable income of the taxpayer, whilst section 70B of the ITAA 1936 operates to allow the taxpayer a deduction for the amount of any loss from their assessable income.

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

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

- (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security,
- (b) a deposit with a bank or other financial institution,
- (c) a secured or unsecured loan, or
- (d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

154. In considering whether the SCN satisfy paragraph (a) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936, each of the SCN is not stock, a bond, certificate of entitlement, bill of exchange, or a promissory note.

155. Paragraph (a) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936 also refers to a debenture. The term 'debenture' in relation to a company is defined by subsection 6(1) of the ITAA 1936 to include debenture stock, bonds, notes and any other securities of the company, whether constituting a charge on the assets of the company or not.

156. The Commissioner has expressed his view in Taxation Determination TD 2009/14 *Income tax: is a taxpayer entitled to an income tax deduction under subsection 70B(2) of the Income Tax Assessment Act 1936 where a Stapled Security of the kind described in Taxpayer Alert TA 2008/1 is sold at a loss or upon the occurrence of an Assignment Event?* as to the scope of a 'debenture' when regard is had to the other instruments specified in the definition of 'debenture'. Paragraphs 23 and 24 of TD 2009/14 state:

23. ...it is the Commissioner's view that 'debenture' for the purposes of the ITAA 1936 encompasses a written instrument whereby one person promises to pay a sum to another person. In other words, the Note would have to be a debt instrument.

24. In order for an instrument to be a 'note', there must be a written acknowledgment of a debt and some promise to pay a sum at some time in the future...

157. Based on the circumstances under which Noteholders may receive a sum under the Terms of Issue of the SCN, it cannot be said that a written acknowledgment of a debt and some promise to pay a sum at some time in the future exists in relation to the SCN. The SCN are therefore not considered to be 'notes' within the definition of a 'debenture' in accordance with the Commissioner's view in TD 2009/14.

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

159. Based on the Terms of Issue of the SCN, there is nothing to evidence an obligation on the part of YSCNL or YAL to pay an amount to Noteholders, either during the term of the instrument or at its maturity. As such, the SCN do not fall within the meaning of the term 'or other security' in the context of paragraph (a) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936.

160. Paragraphs (b) and (c) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936 do not apply because the SCN is neither a deposit with a bank or other financial institution, nor a secured or unsecured loan.

161. Only those contracts that have debt like obligations will usually fall under paragraph (d) of the definition of security (TR 96/14). Nothing in the Terms of Issue of the SCN cause the SCN to be recognised as an instrument with debt like obligations. As such, the SCN do not satisfy paragraph (d) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936.

162. Given that the SCN do not satisfy any of paragraphs (a) to (d) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936, the SCN are not a 'security' within the meaning of that subsection. Therefore, the SCN cannot be a traditional security under subsection 26BB(1) of the ITAA 1936.

163. Section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of Noteholders upon disposal or redemption of their SCN.

164. Section 70B of the ITAA 1936 will not apply to allow a deduction to Noteholders upon disposal or redemption of their SCN.

**Residents***Inclusion of Distributions in assessable income*

165. Paragraph 44(1)(a) of the ITAA 1936 provides that the assessable income of a resident shareholder in a company includes:

- (i) dividends that are paid to the shareholder by the company out of profits derived by it from any source, and
- (ii) all non-share dividends paid to the shareholder by the company.

166. The SCN are a 'non-share equity interest' as defined in subsection 995-1(1). Paragraph 43B(1)(a) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which governs dividends) applies to a non-share equity interest in the same way as it applies to a share.

167. Subsection 995-1(1) states that an 'equity holder' in a company means an entity that holds an equity interest in the company. This Ruling is made on the basis that the SCN are an 'equity interest' in YSCNL under Division 974. Therefore, each of the Noteholders are an 'equity holder' as defined in subsection 995-1(1). Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 applies to an equity holder in the same way as it applies to a shareholder.

168. The Distributions paid in respect of the SCN are 'non-share dividends' as defined in section 974-120. Accordingly, resident Noteholders must include the Distributions paid in respect of the SCN in their assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936 (which means the Distributions are statutory income).

169. The Distributions paid by YSCNL in respect of the SCN are denominated in US dollars and are non-share dividends under section 974-120.

170. Item 7 of the table in subsection 960-50(6) provides the relevant exchange rate at which an amount of statutory income must be translated to Australian currency. Item 7 states that if an amount is received at or before the time when the requirement first arose to include it in the recipient's assessable income, the amount is translated to Australian currency at the exchange rate applicable at the time of receipt. In any other case, the amount is to be translated to Australian currency at the exchange rate applicable at the time when the requirement first arose to include it in the recipient's assessable income.

171. To the extent that the Distributions on the SCN are assessable on a receipts basis, the Noteholders must translate the US dollar denominated Distributions to Australian currency at the exchange rate applicable at the time of receipt, pursuant to item 7 of the table in subsection 960-50(6). Where the Distributions are not assessable on a receipts basis, the amount is to be translated to Australian currency at the exchange rate applicable at the time when the requirement first arose to include the Distribution in the Noteholders' assessable income.

*Inclusion of franking credits in assessable income*

172. Distributions paid in respect of the SCN are non-share dividends under section 974-120. Accordingly, Noteholders who are Australian residents for income tax purposes must include in their assessable income Distributions paid in respect of the SCN under subparagraph 44(1)(a)(ii) of the ITAA 1936.

173. If an entity makes a franked distribution to another entity, subsection 207-20(1) requires that the assessable income of the receiving entity for the year in which the distribution is made includes the amount of the franking credit on the distribution in addition to the amount of the franked distribution. Subsection 207-20(2) provides that the receiving entity is entitled to a tax offset equal to the franking credit on the distribution for the income year in which the distribution is made.

174. Australian resident Noteholders may receive Distributions on the SCN that have been franked. In accordance with subsection 207-20(1), any franking credit attached to a Distribution received by an Australian resident Noteholder must also be included in the relevant Noteholder's assessable income for the income year in which the Distribution is made.

*Entitlement to a franking credit tax offset*

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

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

*Franking credit subject to the refundable tax offset rules*

177. Noteholders who are entitled to a tax offset under subsection 207-20(2) in respect of a franking credit received on a Distribution, will also be subject to the refundable tax offset rules in Division 67, unless they are specifically excluded under section 67-25.

178. 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.

179. Entities excluded under section 67-25 include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions set out in subsections 67-25(1C) or 67-25(1D).

## *Section 177EA of the ITAA 1936*

180. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes designed to obtain imputation benefits. In essence, it applies to schemes for the disposition of membership interests, or an interest in membership interests, in a corporate tax entity where a franked distribution is paid or payable in respect of the membership interests or the interest in membership interests.

181. Where section 177EA of the ITAA 1936 applies, the Commissioner has a discretion pursuant to subsection 177EA(5) of the ITAA 1936 to make a determination to either:

- debit the company's franking account pursuant to paragraph 177EA(5)(a) of the ITAA 1936, or
- deny the imputation benefit on the distribution that flowed directly or indirectly to each shareholder pursuant to paragraph 177EA(5)(b) of the ITAA 1936.

182. Subsection 177EA(3) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies if:

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

183. Subsection 177EA(12) of the ITAA 1936 provides that section 177EA of the ITAA 1936:

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

184. Under this arrangement, the 'relevant taxpayer' is a Noteholder, and the scheme comprises the circumstances surrounding the issue of the SCN to the Noteholders who acquired their SCN by initial application under the Prospectus.

185. In the present case, the conditions in paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied because:

- (a) the issue of the SCN (being a non-share equity interest) pursuant to the Prospectus is a scheme for the disposition of (deemed) membership interests in a corporate tax entity (paragraph 177EA(3)(a) of the ITAA 1936). Paragraph 177EA(14)(a) of the ITAA 1936 provides that a 'scheme for a disposition of membership interests or an interest in membership interests' includes a scheme that involves issuing the membership interests
- (b) on the basis that Distributions on the SCN will not be unfrankable distributions under section 202-45, the Distributions on the SCN are each a frankable distribution that is expected to be payable to the Noteholders (paragraph 177EA(3)(b) of the ITAA 1936).
- (c) the Distributions on the SCN are expected to be a franked distribution to the extent that franking credits are available to be distributed at the time a Distribution is paid (paragraph 177EA(3)(c) of the ITAA 1936), and
- (d) the Noteholders could reasonably be expected to receive imputation benefits as a result of Distributions on the SCN, given that YSCNL expects to frank the Distributions on the SCN to the extent that franking credits are available at the time of the Distribution (paragraph 177EA(3)(d) of ITAA 1936).

186. 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, 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 (each of the Noteholders) to obtain an imputation benefit.



187. In arriving at a conclusion, the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there 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 not be present at any one time in any one scheme.

188. Based on the information provided and the qualifications set out in this Ruling, and having regard to all of the relevant circumstances of the scheme, the Commissioner has concluded that the purpose of enabling the Noteholders to obtain imputation benefits is not more than incidental to YSCNL's purpose of raising funds to assist in refinancing existing borrowings owed by YAL and part fund YAL's existing coal operations and future growth.

189. Accordingly, the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits that are to be received by the Noteholders in respect of the Distributions paid on the SCN.

#### *Imputation benefits – streaming*

190. Subdivision 204-D 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.

191. Section 204-30 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 applies where a corporate tax entity 'streams' the payment of distributions, or the payment of distributions and the giving of other benefits, to its members 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))
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)), 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 disadvantaged member receives other benefits (paragraph 204-30(1)(c)).

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

193. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The words 'derive a greater benefit from franking credits' are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits. The imputation benefit for resident members is in the form of a tax offset (paragraph 204-30(6)(a)), and for non-resident members is in the form of not being liable to pay dividend withholding tax (paragraph 204-30(6)(e)). The resident members derive a greater benefit from franking credits than the non-resident members.

194. In accordance with subsection 709-85(2), Part 3-6 (which includes section 204-30) will apply to Distributions paid on the SCN by YSCNL as if they were paid by YAL to a member of YAL. As such, section 204-30 will be applied as if it were YAL paying the Distributions on the SCN.

195. The SCN were offered on a pro-rata basis to existing YAL shareholders. The SCN have also been listed on the ASX and will therefore be available for investment by different types of investors. Given that the existing YAL shareholders did not take up all of the SCN to which they were entitled, SCN not taken up on a pro-rata basis were allocated to other YAL shareholders who applied to take up more than their pro-rata entitlement. The remaining SCN that were still not taken up were placed in a bookbuild and offered to the market. Foreign residents were not precluded from participating in the Offer, where the Offer is made in accordance with the laws of their jurisdiction.

196. This Ruling is made on the basis that where franked Distributions are paid on the SCN, all Noteholders will receive franked Distributions regardless of their tax attributes or their individual tax position.

197. YAL has not historically paid franked dividends and does not anticipate having sufficient franking credits to pay franked dividends or franked distributions on the SCN in the next three to five years. YAL's policy in relation to the franking of its frankable distributions is not expected to change as a result of the issue of the SCN.

198. The YAL Ordinary Shares allotted on Conversion of the SCN will not attract the application of section 204-30. This is because the issue of Ordinary Shares does not constitute a distribution (as defined in section 960-120), and the allotment of YAL Ordinary Shares will not affect YAL's dividend franking policy.

199. Based on the information provided, the Commissioner has concluded that the requisite element of streaming does not exist in relation to franked distributions that may be paid by YSCNL to Noteholders. Accordingly, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits received by the Noteholders in respect of the Distributions paid on the SCN.

*Gross-up and tax offset*

200. Subdivision 207-F 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. Section 207-145 is relevant to the Noteholders that are the subject of this Ruling.

201. Pursuant to subsection 207-145(1), this adjustment will occur where a franked distribution is made to an entity in one or more of the following circumstances:

- The entity is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of former Part IIIAA of the ITAA 1936 (paragraph 207-145(1)(a));
- 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));
- The Commissioner has made a determination under paragraph 204-30(3)(c) that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(c)); or
- The distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d)).

202. The main test of what constitutes a 'qualified person' in relation to a franked distribution, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, is known as the holding period rule. This test is in former subsection 160APHO(1) of the ITAA 1936, which states:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a qualified person in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, or is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend, or
- (b) where the taxpayer or an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

203. By virtue of former section 160AOA of the ITAA 1936, the holding period rule applies to a non-share equity interest, an equity holder and a non-share dividend in the same way as it applies to a share, a shareholder and a dividend (respectively).

204. Former subsection 160APHO(2) of the ITAA 1936, referred to above, requires the taxpayer to hold the shares or interest in shares for at least 45 days if the shares are not preference shares, or at least 90 days if the shares are preference shares.

205. As the SCN are treated as 'preference shares' (as defined in the former section 160APHD of the ITAA 1936), a shareholder is required to hold the shares on which a dividend has been paid for a continuous period of at least 90 days during the relevant qualification period.

206. In determining whether they hold the shares for at least 90 days during the relevant qualification period, the shareholder does not count the day on which they acquired the shares. If the shareholder has disposed of the shares, they do not count the day on which the disposal occurred.

207. Furthermore, former subsection 160APHO(3) of the ITAA 1936 provides that any days on which the shareholder has materially diminished risks of loss or opportunities for gain in respect of the shares (within the meaning of former sections 160APHM and 160APHJ of the ITAA 1936) are to be excluded when considering the application of former subsection 160APHO(2) of the ITAA 1936. The exclusion of those days is not taken to break the continuity of the period for which the shareholder held the shares.

208. This Ruling is made on the basis that a Noteholder or an associate of a Noteholder has not made, is not under an obligation to make, or is not likely to make, a related payment in respect of any of the Distributions.

209. On the basis that the Noteholders have not made, nor are under an obligation to make, nor are likely to make, a related payment in respect of any of the Distributions, the relevant qualification period is the primary qualification period pursuant to former paragraph 160APHO(1)(a) of the ITAA 1936.

210. Former section 160APHD of the ITAA 1936 defines the 'primary qualification period' in relation to a taxpayer in relation to shares to mean the period beginning on the day after the day on which the taxpayer acquired the shares, and ending, if the shares are preference shares, on the 90th day after the day on which the shares became ex dividend.

211. Former subsection 160APHE(1) of the ITAA 1936 defines the term 'ex dividend' to mean:

A share in respect of which a dividend is to be paid... becomes ex dividend on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

212. This Ruling is made on the basis that Noteholders in receipt of Distributions on the SCN will have held their SCN for a continuous period of at least 90 days (excluding the day of acquisition and disposal) beginning on the day after the acquisition of the SCN.

213. This Ruling is made on the basis that neither a Noteholder, nor an associate of a Noteholder, has taken any position (apart from holding the SCN) in relation to the Noteholder's SCN and subsequently will not have any days where the Noteholder will have a materially diminished risk of loss or opportunities for gain in respect of the SCN that would need to be taken into account due to the application of former subsection 160APHO(3) of the ITAA 1936 when determining the satisfaction of former subsection 160APHO(2) of the ITAA 1936 in relation to that Distribution. This means that the Noteholders will satisfy former subsection 160APHO(2) of the ITAA 1936 in relation to that Distribution.

214. Given that former subsection 160APHO(2) will be satisfied in relation to the Distributions on the SCN for the relevant primary qualification period, each of the Noteholders will be capable of being a 'qualified person' under former paragraph 160APHO(1)(a) of the ITAA 1936.

215. If a Holder of the SCN is not a 'qualified person' under former paragraph 160APHO(1)(a) of the ITAA 1936, or other provisions such as former sections 160APHR or 160APHT of the ITAA 1936, the Noteholder will not be a 'qualified person' for the purposes of Division 1A of former Part IIIA of the ITAA 1936. Section 207-145 will create the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for the Noteholder in relation to payments of some or all of the Distributions.

216. The Commissioner has confirmed above that no determination will be made under paragraph 204-30(3)(c) or paragraph 177EA(5)(b) of the ITAA 1936 to deny the imputation benefits attached to Distributions paid by YSCNL to the Noteholders.

217. Finally, section 207-145 applies where a distribution is made as part of a dividend stripping operation. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to section 207-155, if 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
- had substantially the effect of a scheme by way of, or in the nature of, dividend stripping.

218. The SCN Terms of Issue and Prospectus provide no indication that the offering of the SCN and the potential associated payment of franked Distributions to the Noteholders constitute a dividend stripping arrangement.

219. Therefore, section 207-145 will not apply to the Distributions received by the Noteholders in respect of the SCN. Accordingly, section 207-145 will not adjust the Noteholders' assessable income to exclude an amount of franking credits on the Distributions, nor will it deny the tax offset to which the Noteholders would otherwise be entitled.

***Foreign residents******Liability to withholding tax***

220. Section 128B of the ITAA 1936 imposes withholding tax on the payment of dividends, interest and royalties by Australian residents to non-residents. A non-resident is liable for withholding tax on dividends under subsection 128B(1) of the ITAA 1936.

221. Subsection 128B(1) of the ITAA 1936 states:

Subject to subsections (3), (3A), (3D) and (3E), this section applies to income that:

- (a) is derived, on or after 1 January 1968, by a non-resident, and
- (b) consists of a dividend paid by a company that is a resident.

222. Paragraph 128AAA(1)(c) of the ITAA 1936 provides that Division 11A of Part III of the ITAA 1936 applies to a non-share dividend in the same way as it applies to a dividend.

223. It has been established that a Distribution on the SCN paid by YSCNL will be a non-share dividend as defined in section 974-120.

224. Paragraph 128B(1)(a) of the ITAA 1936 will be satisfied where a payment is made by YSCNL on the SCN to a non-resident. As the payments on the SCN will be considered a dividend and are paid by a resident company (YSCNL), paragraph 128B(1)(b) of the ITAA 1936 will also be satisfied.

225. However, subparagraph 128B(3)(ga)(i) of the ITAA 1936 excludes from subsection 128B(1) of the ITAA 1936 income derived by a non-resident that consists of the franked part of a dividend. Accordingly, a franked part of a Distribution on the SCN will not be subject to Australian withholding tax when derived by a non-resident Noteholder.

226. In addition, subsection 128(3E) of the ITAA 1936 provides that section 128B of the ITAA 1936 does not apply to a dividend (which, by virtue of paragraph 128AAA(1)(c) of the ITAA 1936, includes a non-share dividend) that:

- (a) is paid to a person who is a non-resident carrying on business in Australia at or through a permanent establishment of the person in Australia, and
- (b) is attributable to the permanent establishment, and
- (c) is not paid to the person in the person's capacity as trustee.

227. The class of entities to which this Ruling applies excludes foreign residents who carry on a business in Australia at or through a permanent establishment in Australia. On this basis, the exclusion in subsection 128B(3E) of the ITAA 1936 will not apply to Distributions paid on the SCN.

228. Therefore, a liability to withholding tax will arise under subsection 128B(1) of the ITAA 1936 on the unfranked part of a Distribution paid by YSCNL on the SCN to a non-resident Noteholder.

*No further income tax liability*

229. Subsection 44(1) of the ITAA 1936 will apply to Noteholders of the SCN in the same way it would apply if the Noteholders were shareholders. In relation to non-resident Noteholders subsection 44(1) states:

The assessable income of a shareholder in a company... includes:

...

- (b) if the shareholder is a non-resident:
  - (i) dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia, and
  - (ii) non-share dividends paid to the shareholder by the company to the extent to which they are derived from sources in Australia.

230. However, subsection 44(1) of the ITAA 1936 does not apply to a non-share dividend to the extent to which another provision of the ITAA 1936 that expressly deals with dividends excludes some, or all, of the non-share dividend from the shareholder's assessable income. Note 1 to subsection 44(1) of the ITAA 1936 states that section 128D of the ITAA 1936 is a provision that expressly deals with dividends.

231. Section 128D of the ITAA 1936 states:

Income other than income to which section 128B applies by virtue of subsection (2A), (2C) or (9C) of that section upon which withholding tax is payable, or upon which withholding tax would, but for paragraph 128B(3)(ga), (jb) or (m), section 128F, section 128FA or section 128GB, be payable, is not assessable income and is not exempt income of a person.

232. The overarching application of section 128D of the ITAA 1936 for the purposes of this Ruling is to prevent income on which withholding tax is payable under section 128B of the ITAA 1936 from being included in the assessable income of Noteholders, unless withholding tax is payable on the Distributions as a result of the application of subsection 128B(2A), 128B(2C) or 128B(9C) of the ITAA 1936. Where withholding tax would be payable on the Distributions under section 128B of the ITAA 1936 but is not payable due to the application of paragraph 128B(3)(ga) of the ITAA 1936, section 128D of the ITAA 1936 will still apply to prevent the Distribution from being included in the assessable income of the Noteholder.

233. Distributions paid to non-resident Noteholders will be subject to withholding tax as a result of the application of subsection 128B(1) of the ITAA 1936. Paragraph 128B(3)(ga) of the ITAA 1936 will apply such that no withholding tax will be payable on the Distributions received by non-residents that are franked. As noted above however, this would not prevent the Distributions from satisfying the requirements of section 128D of the ITAA 1936.

234. Therefore, Distributions received by non-resident Noteholders to whom this Ruling applies will not be assessable income, and will not be exempt income, under section 128D of the ITAA 1936. Subsection 44(1) of the ITAA 1936 will not apply to include the Distributions in the assessable income of non-resident Noteholders to whom this Ruling applies.

### **Disposal of SCN**

#### ***Disposal of the SCN – CGT implications***

235. CGT event A1 (section 104-10) happens if there is a disposal of a CGT asset. Each of the SCN is a CGT asset under section 108-5.

236. Subsection 104-10(2) provides the following:

You *dispose of* a CGT asset if a change of ownership occurs from you to another entity, whether because of some act or event or by operation of law. However, a change of ownership does not occur if you stop being the legal owner of the asset but continue to be its beneficial owner.

237. Noteholders will stop being the legal and beneficial owners of the SCN when the disposal of the SCN happens. Therefore, under section 104-10, CGT event A1 happens upon disposal of the SCN.

### **Capital proceeds**

238. Subsection 116-20(1) contains the general rules for calculating the capital proceeds from a CGT event. Specifically, subsection 116-20(1) provides the following:

The *capital proceeds* from a CGT event are the total of:

- (a) the money you have received, or are entitled to receive, in respect of the event happening, and
- (b) the market value of any other property you have received, or are entitled to receive, in respect of the event happening (worked out as at the time of the event).

239. Therefore, the capital proceeds received by the Noteholders from the disposal of the SCN will be equal to the money received and the market value of any property received in respect of the disposal.



***Eligibility to be a discount capital gain***

240. Provided that the requirements of Subdivision 115-A (and, if applicable, Subdivision 115-C) are satisfied, the discount capital gain provisions in Division 115 apply to a capital gain made by an individual, complying superannuation entity, a trust or (in the circumstances set out in paragraph 115-10(d)) a life insurance company.

241. One of those requirements is that the capital gain must result from a CGT event happening to a CGT asset that was acquired by the entity that made the capital gain at least 12 months before the CGT event happened (subsection 115-25(1)).

242. A Noteholder will be entitled to a discount capital gain where the Noteholder is an entity specified in section 115-10, acquired the SCN at least 12 months before the date of disposal and the other conditions in Subdivision 115-A (and, if applicable, Subdivision 115-C) are satisfied.

***Capital gains made by foreign resident Noteholders to be disregarded***

243. Under subsection 855-10(1), an entity disregards a capital gain or capital loss made from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

244. Section 855-15 sets out when a CGT asset is 'taxable Australian property':

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2, or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; or
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

245. None of the items in the above table will apply to deem the SCN to be taxable Australian property. Therefore, a Noteholder will be able to disregard a capital gain or capital loss from a CGT event where they are a foreign resident or the trustee of a foreign trust just before the CGT event, being CGT event A1 (section 104-10) in respect of the disposal, happens.

**Conversion of SCN*****Each of the SCN are a convertible interest***

246. A 'convertible interest' in a company is defined in subsection 995-1(1) as an interest of the kind referred to in item 4 of the table in subsection 974-75(1).

247. Paragraph (b) of item 4 of the table in subsection 974-75(1) refers to an interest issued by the company that is an 'interest that will, or may, convert into an equity interest in the company or a connected entity of the company'.

248. Section 974-165 states that an interest (the first interest) is an interest that will or may convert into another interest (the second interest) if one of a variety of scenarios happens. One such scenario is that the first interest must be or may be satisfied by the issue of the second interest (whether to the holder of the first interest or to some other person) (subparagraph 974-165(b)(i)).

249. Subsection 995-1(1) defines a 'connected entity' of an entity to mean an associate of the entity, or another member of the same wholly owned group if the entity is a company and is a member of such a group. Paragraph 975-500(a) provides that two companies are members of the same wholly-owned group if one of the companies is a 100% subsidiary of the other company. Subsection 975-505(1) provides that a company is a '100% subsidiary' of another company if all the shares in the subsidiary company are beneficially owned by the holding company.

250. YAL owns 100% of the Ordinary Shares in YSCNL and is therefore a 'connected entity' (as defined in subsection 995-1(1)) of YSCNL.

251. The SCN is an interest issued by YSCNL. YAL is a connected entity of YSCNL. The YAL Ordinary Shares are an equity interest in YAL. The SCN may be satisfied by the issue of YAL Ordinary Shares by YAL to the Noteholders where a Noteholder chooses to convert their SCN. The mechanics of Conversion by Noteholders of SCN into YAL Ordinary Shares under the Terms of Issue of the SCN satisfy item 4 of the table in subsection 974-75(1) and subparagraph 974-165(b)(i).

252. Accordingly, each of the SCN are a convertible interest in YSCNL (as defined in subsection 995-1(1) and item 4 of the table in subsection 974-75(1)).

253. The Conversion of the SCN into YAL Ordinary Shares will be the conversion of a convertible interest.

## **CGT event C2**

254. Under paragraph 104-25(1)(f), CGT event C2 happens if an entity's ownership of an intangible CGT asset ends by the asset being converted.

255. As the SCN are convertible interests, Conversion of the SCN for YAL Ordinary Shares constitutes the conversion of a convertible interest. Therefore CGT event C2 will happen to Noteholders on Conversion of the SCN.

256. Conversion of the SCN happens as part of a conversion to which Subdivision 130-C applies. Under subsection 130-60(3), a capital gain or capital loss made from converting a convertible interest is disregarded.

257. Therefore, any capital gain or capital loss made by a Noteholder from CGT event C2 happening on Conversion of the SCN will be disregarded.

## **Cost base and reduced cost base of YAL Ordinary Shares acquired on Conversion**

258. Item 2 of the table in subsection 130-60(1) provides that when you acquire shares by converting a convertible interest that is not a traditional security, the first element of the cost base of the shares is the sum of:

- (a) the cost base of the convertible interest at the time of conversion, and
- (b) any amount paid to convert the convertible interest, except to the extent that the amount is represented in the paragraph (a) amount, and
- (c) all the amounts to be added under subsection 130-60(1A).

259. On Conversion of the SCN, Subdivision 130-C will apply so that the first element of the cost base and reduced cost base of a YAL Ordinary Share acquired on Conversion will be the cost base of the SCN at the time of Conversion divided by the number of YAL Ordinary Shares acquired (item 2 of the table in subsection 130-60(1)).

## **Acquisition time of YAL Ordinary Shares on Conversion**

260. Subsection 130-60(2) states that the shares are acquired when the conversion of the convertible interest happened.

261. YAL Ordinary Shares acquired upon Conversion of the SCN (being convertible interests) will be taken to be acquired when the Conversion happens on the relevant Conversion Date (subsection 130-60(2)).

***Conversion of the SCN into YAL Ordinary Shares not a dividend***

262. The definition of 'dividend' in subsection 6(1) of the ITAA 1936 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.

263. The YAL Ordinary Shares will not be issued to Noteholders of the SCN as shareholders of YAL. Therefore, it would not satisfy paragraphs (a) or (b) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936.

***Conversion of the SCN into YAL Ordinary Shares not a non-share dividend***

264. Under subsection 974-120(1), subject to subsection 974-120(2), all non-share distributions are non-share dividends.

265. Subsection 995-1(1) states that the term 'non-share distribution' has the meaning given by section 974-115.

266. Section 974-115 states that a company makes a non-share distribution to you if:

- (a) you hold a non-share equity interest in the company, and
- (b) the company distributes money or other property to you, or credits an amount to you, as the holder of that non-share equity interest.

267. As previously determined, the SCN represent a non-share equity interest in YSCNL held by the Noteholders, meaning if paragraph 974-115(b) is satisfied then the Noteholder will be taken to have received a non-share distribution under subsection 974-120(1).

268. The issue of YAL Ordinary Shares to Noteholders on Conversion is effected by the Redemption of the SCN by YSCNL who then applies the Face Value of the SCN as payment to YAL as the subscription price for the relevant number of YAL Ordinary Shares to be issued to the Noteholders. The Redemption of the SCN and payment of the Face Value to YAL by YSCNL on behalf of the Noteholder represents YSCNL distributing money to the Noteholder as the holder of a non-share equity interest in YSCNL, thus satisfying paragraph 974-115(b).

269. This means that the application of the Face Value of the SCN as payment to YAL on behalf of the Noteholder is a non-share distribution under section 974-115 and is therefore a non-share dividend under subsection 974-120(1), subject to subsection 974-120(2).

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

271. This Ruling is made on the basis that on Conversion of the SCN, YSCNL will debit an amount (which represents the Face Value of the SCN being Converted) to its non-share capital account. Accordingly, the Face Value of the Converted SCN is not a non-share dividend due to the application of subsection 974-120(2).

### ***No direct value shift***

272. Division 725 may apply where there is a direct value shift under a scheme involving equity interests in an entity. For Division 725 to apply, paragraph 725-145(1)(a) requires there to be a decrease in the market value of one or more equity or loan interests in the target entity.

273. Based on the facts and circumstances of this scheme, there is no decrease in the market value of one or more equity or loan interests in the target entity. Therefore, the conversion of the SCN will not cause a direct value shift under Division 725.

### **Redemption of SCN**

#### ***CGT event C2***

274. Under paragraph 104-25(1)(a), CGT event C2 happens if an entity's ownership of an intangible CGT asset ends by the asset being redeemed.

275. The Noteholder's ownership of the SCN will cease upon YSCNL exercising its option to redeem. As such, CGT event C2 will happen to Noteholders on Redemption of the SCN by YSCNL.

276. Under paragraph 104-25(2), the time of CGT event C2 is when a contract is entered into that results in the asset ending or if there is no contract, when the asset ends.

277. As there will not be a contract entered into to redeem the SCN, the timing of CGT event C2 will be when the SCN are redeemed by YSCNL.

### ***Capital proceeds***

278. Subsection 116-20(1) contains the general rules for calculating the capital proceeds from a CGT event. Specifically, subsection 116-20(1) provides the following:

The *capital proceeds* from a CGT event are the total of:

- (a) the money you have received, or are entitled to receive, in respect of the event happening, and
- (b) the market value of any other property you have received, or are entitled to receive, in respect of the event happening (worked out as at the time of the event).

279. The capital proceeds received by the Noteholders from the Redemption of the SCN by YAL will be equal to the money received and the market value of any property received in respect of CGT event C2 happening.

280. When the Redemption of the SCN occurs, the Noteholders are entitled to receive the Redemption Amount in exchange for the SCN. The Redemption Amount is defined in the SCN Terms of Issue as being:

in respect of any Subordinate Capital Note being redeemed, the aggregate of:

- 1 the Face Value of the Subordinated Capital Note, and
- 2 the aggregate of any accrued (but unpaid) Distributions up to but not including the Redemption Date and any Unpaid Distribution Amounts in respect of the Subordinated Capital Note,

...

281. The Face Value will form part of the capital proceeds for the purposes of paragraph 116-20(1). However, the accrued Distributions and the Unpaid Distribution Amounts are income entitlements which arose from the ownership of the SCN. Where there are any accrued Distributions or Unpaid Distribution Amounts paid as part of the Redemption, these amounts will not be taken to be paid in respect of the Redemption and therefore will not form part of the capital proceeds for the purposes of calculating any capital gain or capital loss.

282. Therefore, the capital proceeds for the purposes of CGT event C2 at the time of Redemption will equal the Face Value of the SCN.

283. The capital proceeds are denominated in US dollars. Item 5 of the table in subsection 960-50(6) provides that where a transaction or event involves an amount of money or the market value of other property and is relevant for the purposes of Part 3-1 or 3-3 (the CGT provisions), the amount or value is to be translated to Australian currency at the exchange rate applicable at the time of the transaction or event.

284. When determining the capital proceeds from CGT event C2 happening on the Redemption of the SCN, the Noteholder must translate the Face Value (being the capital proceeds) to Australian currency at the exchange rate applicable at the time when the SCN are redeemed pursuant to item 5 of the table in subsection 960-50(6).

### ***Eligibility to be a discount capital gain***

285. Provided that the requirements of Subdivision 115-A (and, if applicable, Subdivision 115-C) are satisfied, the discount capital gain provisions in Division 115 apply to a capital gain made by an individual, complying superannuation entity, a trust or (in the circumstances set out in paragraph 115-10(d)) a life insurance company.

286. One of those requirements is that the capital gain must result from a CGT event happening to a CGT asset that was acquired by the entity that made the capital gain at least 12 months before the CGT event happened (subsection 115-25(1)).

287. A Noteholder will be entitled to a discount capital gain where the Noteholder is an entity specified in section 115-10, acquired the SCN at least 12 months before the date of the Redemption by YSCNL and the other conditions in Subdivision 115-A (and, if applicable, Subdivision 115-C) are satisfied.

***Capital gains made by foreign resident Noteholders to be disregarded***

288. Under subsection 855-10(1), an entity disregards a capital gain or capital loss made from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

289. Section 855-15 sets out when a CGT asset is 'taxable Australian property':

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2, or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; or
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

290. None of the items in the above table will apply to deem the SCN to be taxable Australian property. Therefore, a Noteholder will be able to disregard a capital gain or capital loss from a CGT event where they are a foreign resident or the trustee of a foreign trust just before the CGT event, being CGT event C2 (section 104-25) in respect of the Redemption, happens.

***No forex realisation gain or loss on receipt of the Face Value***

291. Upon the Redemption of the US dollar denominated SCN by YSCNL and the receipt of the capital proceeds (being the Face Value) by the Noteholder, forex realisation event 2 will happen as the Noteholder will cease to have a right to receive foreign currency (paragraph 775-45(1)(a)). This is also the time forex realisation event 2 happens under subsection 775-45(2).

292. The Noteholder's right to receive the foreign currency denominated capital proceeds were created, pursuant to subparagraph 775-45(1)(b)(iv), in return for the occurrence of a 'realisation event' in relation to a CGT asset the Noteholder owns (being CGT event C2 happening on the Redemption of the SCN). The right to receive foreign currency arose at the time of Redemption of the SCN.

293. As the Noteholder's right to receive the foreign currency will only arise at the time of the Redemption, there will be no 'currency exchange rate effect' as defined in section 775-105. Therefore, a Noteholder will not make a forex realisation gain pursuant to subsection 775-45(3) or a forex realisation loss pursuant to subsection 775-45(4) from forex realisation event 2 happening when the US dollar denominated Face Value is received upon the Redemption of the SCN.

### **Anti-avoidance provisions on Conversion and Redemption**

#### ***Section 45 of the ITAA 1936***

294. 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%.

295. The SCN are a 'non-share equity interest' as defined in subsection 995-1(1) of the ITAA 1997. Paragraph 43B(1)(a) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which includes section 45) applies to a non-share equity interest in the same way as it applies to a share. Each of the Noteholders are an 'equity holder' as defined in subsection 995-1(1) of the ITAA 1997. Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 applies to an equity holder in the same way as it applies to a shareholder.

#### ***Conversion***

296. YSCNL may pay Distributions on the SCN that will be franked at the same percentage that applies to YAL's Ordinary Shares. All existing shareholders were entitled to participate in the SCN issue on identical terms.

297. At least some of the Noteholders at the time of Conversion will also be holders of YAL Ordinary Shares. While the Conversion of the SCN involves the provision of YAL Ordinary Shares to the Noteholders, any minimally franked dividends that are paid would be received by all shareholders, including those who received shares under the Conversion of the SCN. As such, section 45 will not apply on Conversion of the SCN into YAL Ordinary Shares.



## *Redemption*

298. Redemption at the option of YSCNL requires payment of the Redemption Amount. The Redemption Amount does not include the provision of YAL Ordinary Shares.

299. The Redemption Amount paid on Redemption will not cause section 45 of the ITAA 1936 to apply as it cannot be said that YAL or YSCNL will stream the provision of shares and the payment of minimally franked dividends.

## *Conclusion*

300. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to treat the value of the YAL Ordinary Shares issued to the Noteholders on the Conversion of the SCN, or any part of the Redemption Amount paid to the Noteholders on the Redemption of the SCN, as an unfrankable dividend paid by YSCNL or YAL to the Noteholders.

## **Section 45A of the ITAA 1936**

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

302. If these conditions are satisfied, the Commissioner may 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 part, of the capital benefits. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

303. The SCN are a 'non-share equity interest' as defined in subsection 995-1(1) of the ITAA 1997. Paragraph 43B(1)(a) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which includes section 45A of the ITAA 1936) applies to a non-share equity interest in the same way as it applies to a share. Each of the Noteholders are an 'equity holder' as defined in subsection 995-1(1) of the ITAA 1997. Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 applies to an equity holder in the same way as it applies to a shareholder.

## *Conversion*

304. The provision of capital benefits includes the provision to the shareholder of shares in the company pursuant to paragraph 45A(3)(a) of the ITAA 1936. The issue of YAL Ordinary Shares to Noteholders on Conversion of the SCN will constitute the provision of capital benefits.

305. Subsection 45A(4) of the ITAA 1936 provides a non-exhaustive list of circumstances in which a shareholder would, in a year of income, derive a greater benefit from capital benefits than another shareholder. An application of those prescribed circumstances to the facts of this scheme are as follows:

- the issue of YAL Ordinary Shares on Conversion of the SCN will occur after 20 September 1985 (paragraph 45A(4)(a) of the ITAA 1936)
- YAL will not offer differential treatment to non-residents (paragraph 45A(4)(b) of the ITAA 1936), and
- YAL will not offer differential treatment to Noteholders with different tax profiles (paragraphs 45A(4)(d), (e) and (f) of the ITAA 1936).

306. At least some of the Noteholders at the time of Conversion will also be holders of YAL Ordinary Shares. While the Conversion of the SCN involves the provision of shares (YAL Ordinary Shares) to the Noteholders, any dividends paid would be received by all shareholders, including those who received shares under the Conversion of the SCN. The streaming of the provision of capital benefits and the payment of dividends that is the focus of section 45A would not happen on the Conversion of the SCN.

#### *Redemption*

307. A Redemption will involve the provision of capital benefits pursuant to paragraph 45A(3)(b) of the ITAA 1936 (by virtue of subsection 45A(3A) of the ITAA 1936) as it will constitute a 'non-share capital return' (as defined in subsection 6(1) of the ITAA 1936 and section 974-125). The amount paid to the Noteholders on Redemption will include the Face Value of the SCN, which will be debited against YSCNL's non-share capital account.

308. At least some of the Noteholders at the time of Redemption will also be holders of YAL Ordinary Shares. While the Redemption of the SCN involves the distribution of share capital (in the form of cash) to the Noteholders, any dividends paid would be received by all shareholders, including those who received a distribution of share capital under the Redemption of the SCN.

309. The Unpaid Distribution Amounts which form part of the Redemption Amount will be debited to an account other than the non-share capital account of YSCNL and do not represent the provision of capital benefits for the purposes of section 45A(3) of the ITAA 1936.

310. Accordingly, it cannot be said that Noteholders would derive a greater benefit from capital benefits than other YAL shareholders.

*Conclusion*

311. 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 capital benefits provided to the Noteholders of the SCN when the YAL Ordinary Shares are issued to the Noteholders on the Conversion of the SCN or when there is a Redemption.

**Section 45B of the ITAA 1936**

312. Section 45B of the ITAA 1936 applies where under a scheme, a person is provided with a capital benefit by a company, a taxpayer obtains a tax benefit and, having regard to the relevant circumstances of the scheme, it would be concluded that a party to the scheme had a more than incidental purpose of enabling the relevant taxpayer to obtain a tax benefit.

313. If these conditions are satisfied, the Commissioner may make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the capital benefit. The effect of such a determination is that the affected capital benefit is taken to be an unfranked dividend.

314. The SCN are a 'non-share equity interest' as defined in subsection 995-1(1) of the ITAA 1997. Paragraph 43B(1)(a) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which includes section 45B of the ITAA 1936) applies to a non-share equity interest in the same way as it applies to a share. Each of the Noteholders are an 'equity holder' as defined in subsection 995-1(1) of the ITAA 1997. Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 applies to an equity holder in the same way as it applies to a shareholder.

315. Specifically, section 45B of the ITAA 1936 applies where:

- (i) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936)
- (ii) under the scheme a taxpayer, who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit (paragraph 45B(2)(b) of the ITAA 1936), and
- (iii) 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 (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

*Conversion*

316. The arrangement involving the issue of the SCN according to the Terms of Issue, including the issue of the YAL Ordinary Shares to the Noteholders on the Conversion of the SCN, will constitute a scheme under which the Noteholders are provided with a capital benefit by YAL (paragraph 45B(5)(a) of the ITAA 1936). Paragraph 45B(2)(a) of the ITAA 1936 is satisfied.

317. The relevant taxpayers are the Noteholders (who also happen to be the persons provided with the capital benefit). The issue of the YAL Ordinary Shares to the Noteholders on the Conversion of the SCN will not lead to the Noteholders deriving assessable income or making a capital gain. By contrast, an assessable dividend would be included in the assessable income of the Noteholders. Therefore, the Noteholders will generally obtain a tax benefit from the scheme. Paragraph 45B(2)(b) of the ITAA 1936 is satisfied.

318. Paragraph 45B(2)(c) of the ITAA 1936 requires that, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit. A non-exhaustive list of relevant circumstances of the scheme are provided in subsection 45B(8) of the ITAA 1936.

319. Having regard to the relevant circumstances surrounding the issue of YAL Ordinary Shares on Conversion, it cannot be concluded that YAL, the Noteholders or any other person intended to enter into or carry out the Conversion of the SCN for YAL Ordinary Shares for the purpose of enabling the Noteholders to obtain a tax benefit. Therefore, paragraph 45B(2)(c) of the ITAA 1936 is not satisfied.

*Redemption*

320. The Redemption of the SCN includes a payment of the Face Value of the SCN. The payment of the Face Value amount for the SCN will be debited against the non-share capital account of YSCNL.

321. The Redemption of the SCN according to the Terms of Issue will also constitute a scheme under which the Noteholders are provided with a capital benefit by YSCNL (paragraph 45B(5)(b) of the ITAA 1936 by virtue of subsection 45B(7) of the ITAA 1936 as it will constitute a 'non-share capital return' (as defined in subsection 6(1) of the ITAA 1936 and section 974-125)).

322. The effect of section 43B and subsection 45B(7) of the ITAA 1936 is that a non-share distribution to an equity holder is taken to be the distribution to the equity holder of share capital to the extent to which it is a non-share capital return. The Redemption of the SCN for the Face Value for each of the SCN that are being redeemed will generally not lead to the Noteholders deriving assessable income or making a capital gain. By contrast, an assessable dividend would be included in the assessable income of the Noteholders.

323. Having regard to the relevant circumstances of the scheme in subsection 45B(8) of the ITAA 1936, and on the basis of the information surrounding the issue of the SCN, the Commissioner has concluded that neither YSCNL, YAL, the Noteholders or any other person who entered into or carried out any part of the scheme did so for a more than incidental purpose of enabling the Noteholders to obtain a tax benefit. Therefore, paragraph 45B(2)(c) of the ITAA 1936 is not satisfied.

## *Conclusion*

324. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the capital benefit provided to the Noteholders of the SCN when the YAL Ordinary Shares are issued to the Noteholders on the Conversion of the SCN or when there is a Redemption.

## Appendix 2 – Detailed contents list

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

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Relevant provision(s)	2
Class of entities	3
Qualifications	5
<b>Date of effect</b>	<b>17</b>
<b>Scheme</b>	<b>18</b>
Relevant entities	20
YAL	20
YSCNL	24
The offer of SCN	26
Reasons for issuing the SCN	31
Main features of the SCN	32
<i>Distribution calculation</i>	34
<i>Distribution payment conditions</i>	43
<i>Conversion</i>	49
<i>Redemption</i>	53
<i>Redemption on Winding Up</i>	54
<i>Redemption at the option of YSCNL</i>	55
<i>Redemption – Redemption event</i>	57
<i>Redemption – clean up option</i>	58
<i>Redemption Amount</i>	59
<i>Resale</i>	61
<i>Purchase</i>	66
<i>Cancellation</i>	67
<i>Payments</i>	68
<i>No other rights</i>	70
Other matters	72
<b>Ruling</b>	<b>73</b>
Issuance of the SCN	73
<i>Acquisition time of the SCN</i>	73
<i>Cost base and reduced cost base of the SCN</i>	74
<i>No direct value shift</i>	76

Inclusion of Distributions and franking credits in assessable income	77
<i>General</i>	77
<i>Non-share dividends</i>	77
<i>Frankable distribution</i>	78
<i>No forex realisation gain or loss on receipt of Distributions</i>	80
<i>Each of the SCN will not be a traditional security</i>	81
<i>Residents</i>	83
<i>Inclusion of Distributions in assessable income</i>	83
<i>Inclusion of franking credits in assessable income</i>	85
<i>Entitlement to a franking credit tax offset</i>	86
<i>Franking credit subject to the refundable tax offset rules</i>	87
<i>Section 177EA of the ITAA 1936</i>	88
<i>Imputation benefits – streaming</i>	89
<i>Gross-up and tax offset</i>	90
<i>Foreign residents</i>	91
<i>Liability to withholding tax</i>	91
<i>No further income tax liability</i>	92
<i>Disposal of SCN</i>	93
<i>Disposal of the SCN – CGT implications</i>	93
<i>Capital proceeds</i>	94
<i>Eligibility to be a discount capital gain</i>	95
<i>Capital gain made by foreign resident Noteholders to be disregarded</i>	96
<i>Conversion of SCN</i>	97
<i>Each of the SCN are a convertible interest</i>	97
<i>CGT event C2</i>	98
<i>Cost base and reduced cost base of YAL Ordinary Shares acquired on Conversion</i>	100
<i>Acquisition time of YAL Ordinary Shares on Conversion</i>	101
<i>Conversion of the SCN into YAL Ordinary Shares not a dividend</i>	102
<i>Conversion of the SCN into YAL Ordinary Shares not a non-share dividend</i>	103
<i>No direct value shift</i>	104
<i>Redemption of SCN</i>	105

<i>CGT event C2</i>	105
<i>Capital proceeds</i>	107
<i>Eligibility to be a discount capital gain</i>	109
<i>Capital gain made by foreign resident Noteholders to be disregarded</i>	110
<i>No forex realisation gain or loss on receipt of the Face Value</i>	111
Anti-avoidance provisions on Conversion and Redemption	112
<i>Section 45 of the ITAA 1936</i>	112
<i>Section 45A of the ITAA 1936</i>	113
<i>Section 45B of the ITAA 1936</i>	114
<b>Appendix 1 – Explanation</b>	<b>115</b>
Issuance of the SCN	115
<i>Acquisition time of the SCN</i>	115
<i>Cost base and reduced cost base of the SCN</i>	117
<i>No direct value shift</i>	121
Inclusion of Distributions and franking credits in assessable income	123
<i>General</i>	123
<i>Non-share dividends</i>	123
<i>Frankable distribution</i>	132
<u><i>Distributions taken to be made by YAL</i></u>	136
<i>No forex realisation gain or loss on receipt of Distributions</i>	143
<i>Each of the SCN will not be a traditional security</i>	151
<i>Residents</i>	165
<i>Inclusion of Distributions in assessable income</i>	165
<i>Inclusion of franking credits in assessable income</i>	172
<i>Entitlement to a franking credit tax offset</i>	175
<i>Franking credit subject to the refundable tax offset rules</i>	177
<i>Section 177EA of the ITAA 1936</i>	180
<i>Imputation benefits – streaming</i>	190
<i>Gross-up and tax offset</i>	200
<i>Foreign residents</i>	220
<i>Liability to withholding tax</i>	220
<i>No further income tax liability</i>	229
Disposal of SCN	235



<i>Disposal of the SCN – CGT implications</i>	235
<i>Capital proceeds</i>	238
<i>Eligibility to be a discount capital gain</i>	240
<i>Capital gains made by foreign resident Noteholders to be disregarded</i>	243
Conversion of SCN	246
<i>Each of the SCN are a convertible interest</i>	246
<i>CGT event C2</i>	254
<i>Cost base and reduced cost base of YAL Ordinary Shares acquired on Conversion</i>	258
<i>Acquisition time of YAL Ordinary Shares on Conversion</i>	260
<i>Conversion of the SCN into YAL Ordinary Shares not a dividend</i>	262
<i>Conversion of the SCN into YAL Ordinary Shares not a non-share dividend</i>	264
<i>No direct value shift</i>	272
Redemption of SCN	274
<i>CGT event C2</i>	274
<i>Capital proceeds</i>	278
<i>Eligibility to be a discount capital gain</i>	285
<i>Capital gains made by foreign resident Noteholders to be disregarded</i>	288
<i>No forex realisation gain or loss on receipt of the Face Value</i>	291
Anti-avoidance provisions on Conversion and Redemption	294
Section 45 of the ITAA 1936	294
<i>Conversion</i>	296
<i>Redemption</i>	298
<i>Conclusion</i>	300
Section 45A of the ITAA 1936	301
<i>Conversion</i>	304
<i>Redemption</i>	307
<i>Conclusion</i>	311
Section 45B of the ITAA 1936	312
<i>Conversion</i>	316
<i>Redemption</i>	320
<i>Conclusion</i>	324
<b>Appendix 2 – Detailed contents list</b>	<b>325</b>

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Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 96/14; TR 2006/10; TD 2009/14

### *Subject references:*

- acquisition of CGT assets
- anti-avoidance measures
- CGT capital proceeds
- CGT cost base
- CGT discount
- CGT event A1 –disposal of a CGT asset
- CGT event C2 –end of a CGT asset
- CGT reduced cost base
- Division 45
- frankable distributions
- franking credits
- income
- non-assessable non-exempt income
- non-resident dividend withholding tax
- non-share equity interest
- qualified person
- time of CGT event
- traditional securities
- unfranked dividends
- value shifting – entity interests
- direct value shifting rules

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