CR 2015/64 - Income tax: Westpac Banking Corporation - Westpac Capital Notes 3

Class Ruling

Income tax: Westpac Banking Corporation – Westpac Capital Notes 3

Contents **Para**

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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 26BB of the ITAA 1936
- subsection 44(1) of the ITAA 1936
- section 45 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 70B of the ITAA 1936
- Division 1A of former Part IIIAA of the ITAA 1936
- section 177EA of the ITAA 1936

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 8-1 of the ITAA 1997
- Division 67 of the ITAA 1997
- section 67-25 of the ITAA 1997
- section 104-10 of the ITAA 1997
- section 104-25 of the ITAA 1997
- section 109-10 of the ITAA 1997
- section 110-25 of the ITAA 1997
- section 110-55 of the ITAA 1997
- section 130-60 of the ITAA 1997
- section 204-30 of the ITAA 1997
- Subdivision 207-D of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-145 of the ITAA 1997
- section 974-75 of the ITAA 1997
- section 974-120 of the ITAA 1997, and
- section 974-165 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are subscribers of Westpac Capital Notes 3 (WCN 3) issued by Westpac Banking Corporation (Westpac) who:

- are Australian residents (within the meaning of subsection 6(1) of the ITAA 1936)
- hold their WCN 3 on capital account, and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to financial arrangements under the scheme.

  (Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them).

In this Ruling, a person belonging to this class of entities is referred to as a Holder.

4. The class of entities to which this Ruling applies does not extend to Holders of WCN 3 who acquired their WCN 3 otherwise than by initial application under the Westpac Capital Notes 3 Prospectus dated and lodged with the Australian Securities and Investments Commission on 6 August 2015 (Prospectus).

Qualifications

5. This Ruling does not deal with how the taxation law applies to Holders who hold their WCN 3 as trading stock or revenue assets.

6. This Ruling does not consider the tax implications of Conversion of the WCN 3 on the occurrence of a Capital Trigger Event, Non-Viability Trigger Event, Acquisition Event or Conversion where the Holder does not wish to receive Ordinary Shares or is an Ineligible Holder.

7. This Ruling does not consider how the taxation law applies to a Nominated Party who acquires their WCN 3 under a Transfer Notice.

8. This Ruling does not consider the tax implications of the buy-back of the WCN 3 from the Nominated Party by Westpac.

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

10. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 66 of this Ruling.

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

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

Date of effect

12. This Ruling applies from 1 October 2014 to 30 September 2023. The Ruling continues to apply after 30 September 2023 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).

Scheme

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

- application for class ruling dated 1 December 2014
- the Prospectus, and
- Westpac Capital Notes 3 Terms (Terms) dated 6 August 2015 in Appendix B of the Prospectus.

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

14. In this Ruling, unless otherwise defined, capitalised terms take their meaning as specified in the Prospectus and Terms.

15. Westpac is an Australian resident company for income tax purposes. Westpac is listed on the Australian Securities Exchange (ASX).

16. Westpac is an authorised deposit-taking institution for the purposes of the *Banking Act 1959* and is subject to regulatory requirements as administered by the Australian Prudential Regulation Authority (APRA), including maintenance of minimum levels of Tier 1 Capital.

17. On 5 August 2015 Westpac announced to the ASX its intention to raise approximately $1.25 billion of Additional Tier 1 Capital through the offer of WCN 3.

18. The proceeds from the issue of the WCN 3 will be used by Westpac for general funding purposes.

19. The WCN 3 have been confirmed by APRA to meet the criteria of Additional Tier 1 Capital for the purposes of the Prudential Standard APS 111 implemented under the Basel III capital reforms (commencing from 1 January 2013).

20. The issue date for the WCN 3 is 8 September 2015. The WCN 3 are expected to be listed on the ASX and trade under the ASX code 'WBCPF'.

21. The offer consists of a Securityholder Offer, a Broker Firm Offer, and an Institutional Offer.

22. The Securityholder Offer is available to registered holders of Ordinary Shares, Westpac TPS, Westpac CPS, Westpac Subordinated Notes 2012, Westpac Subordinated Notes 2013, Westpac Capital Notes and/or Westpac Capital Notes 2 as at 7.00pm Sydney time on 20 July 2015 and who are shown on the register as having an address in Australia.

23. The Broker Firm Offer is available to Australian resident retail clients of the Syndicate Brokers who apply for a broker firm Allocation from a Syndicate Broker under the Prospectus.

24. The Institutional Offer is available to Institutional Investors invited by Westpac Institutional Bank to bid for the WCN 3 in the Bookbuild.

25. There is no general public offer of the WCN 3. However, Westpac reserves the right to accept applications from persons other than Eligible Securityholders, Broker Firm Applicants and Institutional Investors at its discretion.

26. No action has been taken to register or qualify the WCN 3 or the offer of the WCN 3 to otherwise permit a public offering of WCN 3 in any jurisdiction outside of Australia.

Main features of the WCN 3

27. The WCN 3 are Australian dollar denominated fully paid, non-cumulative, convertible, transferable, redeemable, subordinated, perpetual, unsecured notes issued by Westpac, through its London branch.

28. The issue price for each WCN 3 is $100.

Distribution payment conditions

29. Payment of any Distribution on a Distribution Payment Date is subject to:

(a) Westpac's absolute discretion

(b) the payment not resulting in a breach of Westpac's capital requirements (on a Level 1 basis) or of the Westpac Group's capital requirements (on a Level 2 basis) under the applicable Prudential Standards and guidelines published by APRA at the time of the payment

(c) the payment not resulting in Westpac becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*, and

(d) APRA not otherwise objecting to the payment of the Distribution.

30. A Distribution is only payable to those persons registered as a holder of the WCN 3 on the Record Date for that Distribution.

31. Distributions are only payable in cash and are non-cumulative. If payment of any Distribution is not paid, Westpac has no liability to pay the Distribution to the Holder and the Holder will have no claim, including in a Winding Up, or right to apply for Winding Up in respect of the non-payment. Non-payment of a Distribution does not constitute an event of default.

32. If a Distribution has not been paid to Holders in full on the relevant Distribution Payment Date, Westpac must not determine or pay any dividends on Ordinary Shares or undertake any discretionary Buy Back or Capital Reduction unless the amount of the unpaid Distribution is paid in full within 20 Business Days of that Distribution Payment Date or:

(a) all WCN 3 have been Converted or Redeemed, or

(b) on a subsequent Distribution Payment Date, a Distribution for the subsequent Distribution Period is paid in full, or

(c) a Special Resolution of the Holders has been passed approving such action,

and APRA does not otherwise object to the actions listed in (a), (b) or (c) as applicable. The dividend and capital restrictions do not apply in certain circumstances.

Distribution calculation

33. Subject to the conditions outlined at paragraph 29 of this Ruling, each WCN 3 entitles the Holder to receive on the relevant Distribution Payment Date interest on the Face Value of the WCN 3 (***Distribution***), calculated using the following formula:

$$\textbf{Distribution} = \frac{\textbf{Distribution Rate} \times \textbf{Face Value} \times \textbf{N}}{\textbf{365}}$$

where:

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

Distribution Rate = (Bank Bill Rate + Margin) x (1 – Tax Rate)

where:

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

(a) the rates otherwise bid and offered for bills of a term of 90 days or for funds of that tenor displayed on Reuters page BBSW (or any page which replaces that page) at that time on that date, and

(b) if bid and offer rates for bills of a term of 90 days are not otherwise available, the rates otherwise bid and offered for funds of that tenor at or around that time on that date,

Margin is 4.00% per annum

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

N means, in respect of a Distribution Period, the number of days in that Distribution Period.

34. Distributions are expected to be fully franked. However, if any Distribution is not fully franked or only partially franked (other than because of an act by, or circumstance affecting the particular Holder), the Distribution will be grossed-up to the extent that the franking percentage of the Distribution is less than 100%.

Scheduled Conversion

35. Each WCN 3 converts to a fully paid ordinary share in the capital of Westpac (in other words an Ordinary Share) on the date that is the earlier of:

(a) 22 March 2023, and

(b) the first Distribution Payment Date after 22 March 2023,

on which the Scheduled Conversion Conditions are satisfied (each a Scheduled Conversion Date).

36. The Scheduled Conversion Conditions are satisfied where:

(a) the volume weighted average price (VWAP) of Ordinary Shares on the 25th Business Day prior to (but not including) the Scheduled Conversion Date is greater than 56.12% of the Issue Date VWAP (First Scheduled Conversion Condition), and

(b) the VWAP of Ordinary Shares during the period of 20 Business Days prior to (but not including) the Scheduled Conversion Date is greater than 50.51% of the Issue Date VWAP (Second Scheduled Conversion Condition).

37. Holders have no right to request Conversion of their WCN 3 at any time.

Automatic Conversion

38. Automatic Conversion happens upon the occurrence of:

(a) a Capital Trigger Event, or

(b) a Non-Viability Trigger Event, or

(c) an Acquisition Event, subject to the satisfaction of the modified Second Scheduled Conversion Condition.

Capital Trigger Event

39. A Capital Trigger Event occurs when Westpac determines, or APRA notifies Westpac that it believes, that the Westpac Level 1 Common Equity Tier 1 Capital Ratio and/or Westpac Level 2 Common Equity Tier 1 Capital Ratio (as defined by APRA in its Prudential Standards) is equal to or less than 5.125%.

40. If a Capital Trigger Event occurs, Westpac must notify APRA and convert such number of WCN 3 (or, if it so determines, such percentage of the Face Value of each WCN 3) as is sufficient following conversion or write-down of other Tier 1 Capital of Westpac on a Level 1 or Level 2 basis (Relevant Securities), to return either or both of those capital ratios, as the case may be, to above 5.125%.

Non-Viability Trigger Event

41. A Non-Viability Trigger Event occurs when APRA notifies Westpac in writing that it believes:

(a) Conversion of all or some WCN 3, or Conversion or write down of capital instruments of the Westpac Group, is necessary because, without it, Westpac would become non-viable, or

(b) a public sector injection of capital, or equivalent support, is necessary because, without it, Westpac would become non-viable.

42. If a Non-Viability Trigger Event occurs due to an APRA determination that a public sector injection of capital or equivalent support is required, Westpac must convert all of the WCN 3.

43. If a Non-Viability Trigger Event occurs for other reasons, Westpac must convert such number of WCN 3, (or, if it so determines, such percentage of the Face Value of each WCN 3), as is equal (following conversion or write-down of other Relevant Securities whose terms require them to be converted or written down before Conversion of WCN 3) to the aggregate face value of capital instruments which APRA has notified Westpac must be converted or written down (or, if APRA has not so notified Westpac, such number or, if Westpac so determines, such percentage of the Face Value of WCN 3, as is necessary (when added to the amount of other Relevant Securities converted or written down) to satisfy APRA that Westpac will no longer be non-viable).

44. The Scheduled Conversion Conditions do not apply to Conversions as a result of a Capital Trigger Event or a Non-Viability Trigger Event.

Automatic Conversion upon the occurrence of a Capital Trigger Event or a Non-Viability Trigger Event

45. If a Capital Trigger Event or Non-Viability Trigger Event has occurred and all or some WCN 3 (or a percentage of the Face Value of each WCN 3) are required to be Converted, then:

(a) Conversion of the relevant WCN 3 or percentage of the Face Value of each WCN 3 will be taken to have occurred on the Capital Trigger Event Conversion Date or Non-Viability Trigger Event Conversion Date

(b) the entry of the corresponding WCN 3 in each relevant Holder's holding in the WCN 3 Register will constitute an entitlement of that Holder to the relevant number of Ordinary Shares (and, if applicable, also to any remaining balance of WCN 3 or WCN 3 with a Face Value equal to the aggregate of the remaining percentage of the Face Value of each WCN 3), and Westpac will recognise the Holder as having been issued the relevant Ordinary Shares for all purposes, in each case without the need for any further act or step by Westpac, the Holder or any other person (and Westpac will, as soon as possible thereafter and without delay on the part of Westpac, take any appropriate procedural steps to record such Conversion, including updating the WCN 3 Register and the Westpac Ordinary Share register), and

(c) upon Conversion a Holder has no further right or claim in respect of the WCN 3 Converted, except in relation to the relevant number of Ordinary Shares and the Holder's entitlement, if any, to WCN 3 representing the unconverted outstanding Face Value.

No further rights if Conversion cannot occur

46. If for any reason Conversion of any WCN 3 (or a percentage of the Face Value of any WCN 3) required to be Converted upon the occurrence of a Capital Trigger Event or Non-Viability Trigger Event fails to take effect or does not occur for any other reason and the Ordinary Shares are not issued for any reason in respect of such Conversion by 5.00pm on the fifth Business Day after the Capital Trigger Event Conversion Date or Non-Viability Trigger Event Conversion Date, then the relevant Holders' rights (including to payment of Distributions and Face Value and any other payments) in relation to such WCN 3 or percentage of the Face Value of the WCN 3 are immediately and irrevocably terminated and such termination will be taken to have occurred immediately upon the Capital Trigger Event Date or Non-Viability Trigger Event Date, as the case may be.

Acquisition Event

47. If an Acquisition Event occurs then Westpac must Convert all WCN 3 provided the modified Second Scheduled Conversion Condition is satisfied. The modified Second Scheduled Conversion Condition applies to a Conversion following an Acquisition Event as though the proposed Acquisition Event Conversion Date were a Scheduled Conversion Date for the purposes of Scheduled Conversion (except that in the case of an Acquisition Event, the Second Scheduled Conversion Condition will apply as if it referred to 20.20% of the Issue Date VWAP).

48. Conversion pursuant to an Acquisition Event will occur:

(a) in the case of an Acquisition Event that is a takeover bid, on a date no later than the Business Day prior to then announced closing date of the relevant takeover bid, or

(b) in the case of an Acquisition Event that is a court approved scheme, on a date no later than the record date for participation in the relevant scheme of arrangement.

Optional Conversion

49. Westpac may at its option Convert:

(a) all or some WCN 3 on 22 March 2021 provided if on the second Business Day before the date on which an Optional Conversion Notice is sent by Westpac, the VWAP on that date is greater than 56.12% of the Issue Date VWAP, or

(b) all (but not some) of the WCN 3 on an Optional Conversion Date following the occurrence of a Tax Event or Regulatory Event provided if on the second Business Day before the date on which an Optional Conversion Notice is sent by Westpac, the VWAP on that date is greater than 22.20% of the Issue Date VWAP.

50. If the modified Second Scheduled Conversion Condition is not satisfied on the proposed Optional Conversion Date:

(a) the WCN 3 will not Convert, and

(b) Westpac will notify Holders as soon as practicable after the proposed Optional Conversion Date that Conversion did not occur.

51. Optional Conversion may occur even if Westpac, in its absolute discretion, does not pay a Distribution for the final Distribution Period.

Ordinary Shares issued on Conversion

52. On Conversion:

(a) Westpac will allot and issue a number (the Conversion Number) of Ordinary Shares for each WCN 3 held by the Holder, and

(b) each Holder's rights (including to Distributions) in relation to each WCN 3 that is being Converted will be immediately and irrevocably terminated for an amount equal to the Face Value and Westpac will apply the Face Value of each WCN 3 by way of payment for the subscription for the Ordinary Shares to be allotted and issued using the Conversion Number. Holders do not have any right to payment in any other way.

53. The Conversion Number is calculated according to the following formula:

$$\text{Conversion Number for each WCN 3} = \frac{\text{Face Value}}{0.99 \times \text{VWAP}}$$

but is subject to it being no greater than the Maximum Conversion Number which is calculated as follows:

$$\text{Maximum Conversion Number} = \frac{\text{Face Value}}{\text{Relevant Percentage} \times \text{Issue Date VWAP}}$$

54. The Relevant Percentage will be 0.50 if Conversion occurs on a Scheduled Conversion Date or the Optional Conversion Date and 0.20 if Conversion occurs at any other time.

55. The effective 1% discount on Conversion of the WCN 3 to Ordinary Shares is customary practice in the market for equity of this kind and is designed to compensate investors for transaction costs (i.e. brokerage) which may be incurred on the disposal of the Ordinary Shares they receive on Conversion of the WCN 3.

Optional Redemption

56. Subject to APRA approval, Westpac may at its option Redeem the WCN 3 in certain circumstances. Redemption means redemption of WCN 3 for their Face Value.

57. The circumstances in which Redemption may occur include:

(a) Redemption of all or some WCN 3 at the option of Westpac on 22 March 2021, and

(b) Redemption of all (but not some) WCN 3 on a Redemption Date following the occurrence of a Tax Event or Regulatory Event.

58. Westpac may only Redeem if:

(a) before or concurrently with Redemption, Westpac replaces WCN 3 with a capital instrument which is of the same or better quality than WCN 3, or APRA confirms that Westpac is not required to replace WCN 3, and

(b) APRA has given its prior written approval to the Redemption.

59. Redemption may occur even if Westpac, in its absolute discretion, does not pay a Distribution for the final Distribution Period.

60. Holders of WCN 3 do not have a right to request Redemption of their WCN 3 at any time.

Transfer on the optional Transfer Date

61. Westpac may elect that Transfer occur in relation to all or some WCN 3 on 22 March 2021 or all (but not some) of the WCN 3 on a Transfer Date following the occurrence of a Tax Event or Regulatory Event.

62. Transfer means the Transfer of WCN 3 by Holders to a Nominated Party for a cash amount per WCN 3 equal to the Face Value. Nominated Party means one or more third parties selected by Westpac in its absolute discretion (which cannot include a member of the Westpac Group).

63. If Westpac elects to Transfer by issuing a Transfer Notice:

(a) each Holder is taken irrevocably to offer to sell the relevant number of their WCN 3 to the Nominated Party on the Transfer Date for a cash amount per WCN 3 equal to the Face Value (and to have appointed Westpac as its agent and attorney to execute documents and do all things necessary in connection with that offer and any resulting sale), and

(b) on the Transfer Date, subject to payment by the Nominated Party of the Face Value to Holders, all right, title and interest in the relevant number of WCN 3 will be Transferred from the Holders to the Nominated Party.

64. Transfer may occur even if Westpac, in its absolute discretion, does not pay a Distribution for the final Distribution Period.

65. Holders do not have a right to request Transfer of their WCN 3.

Other matters

66. The Ruling is made on the basis that:

(a) during the term of the scheme, Westpac will be a resident of Australia under the income tax laws of Australia

(b) the WCN 3 are equity interests in Westpac for the purposes of Division 974 of the ITAA 1997 and constitute non-share equity interests as defined in subsection 995-1(1) of the ITAA 1997

(c) the Ordinary Shares obtained by a Holder on Conversion of the WCN 3 will be equity interests under Division 974 of the ITAA 1997

(d) Distributions are frankable distributions under section 202-40 of the ITAA 1997

(e) Westpac will frank Distributions in accordance with Division 203 of the ITAA 1997 and at the same franking percentage as the Westpac income tax consolidated group benchmark for the franking period in which the Distributions are made

(f) Westpac will not differentially frank Distributions to different Holders in respect of the WCN 3 according to the tax status of Holders or on any other basis

(g) Westpac expects to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account)

(h) The dividend payout ratios and Westpac's policies in relation to the franking of its distributions on ordinary share capital, other preference share capital, and non-share equity interests of Westpac (to the extent such dividends/distributions are frankable) are not expected to change as a result of the issue of the WCN 3

(i) Distributions and any gross-up amounts payable in respect of the WCN 3 will not be debited to Westpac's share capital account (within the meaning of section 975-300 of the ITAA 1997) or non-share capital account (within the meaning of section 164-10 of the ITAA 1997)

(j) Distributions will not be sourced, directly or indirectly, from Westpac's share capital account or non-share capital account

(k) the share capital account of Westpac will not become tainted (within the meaning of Division 197 of the ITAA 1997) by the issue of the WCN 3 or Ordinary Shares on Conversion

(l) immediately before payment of a Distribution, Westpac will have sufficient available frankable profits (worked out under section 215-20 of the ITAA 1997) to pay the Distribution

(m) on Conversion or Redemption of the WCN 3, Westpac will debit the Face Value of the WCN 3 to a non-share capital account (within the meaning of section 164-10 of the ITAA 1997)

(n) Holders, and their associates, will not have taken any positions (within the meaning of former section 160APHJ of the ITAA 1936) in relation to the WCN 3 (apart from the holding of the WCN 3) that would cause a Holder not to be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936

(o) Holders, and their associates, will not make any related payments (within the meaning of former section 160APHN of the ITAA 1936) in relation to Distributions

(p) Holders will not dispose of their WCN 3 before a period of at least 90 days (excluding the date of acquisition and disposal) beginning the day after the acquisition of the WCN 3

(q) the accounts of the Westpac group are prepared in accordance with applicable accounting standards, and

(r) all parties to the scheme are dealing with each other at arm's length.

Ruling

Acquisition of the WCN 3 – CGT implications

Acquisition time of the WCN 3

67. Under item 2 of the table in section 109-10 of the ITAA 1997, a Holder will acquire their WCN 3 on 8 September 2015, being the date the WCN 3 is issued to them.

Cost base and reduced cost base of the WCN 3

68. The first element of the cost base and reduced cost base of each WCN 3 is $100, being the money paid by the Holder to acquire the WCN 3 from Westpac (subsections 110-25(2) and 110-55(2) of the ITAA 1997).

Inclusion of Distributions and franking credits in assessable income

69. Distributions are non-share dividends under section 974-120 of the ITAA 1997 and must be included in the Holders' assessable income (subparagraph 44(1)(a)(ii) of the ITAA 1936).

70. Holders must also include in their assessable income an amount equal to the franking credits attached to the Distribution (subsection 207-20(1) of the ITAA 1997).

Entitlement to a tax offset

71. Holders will be entitled to a tax offset equal to the franking credit received on Distributions (subsection 207-20(2) of the ITAA 1997) unless the Distribution is exempt income or non-assessable non-exempt income in the hands of the Holder.

Exempt income or non-assessable non-exempt income

72. To the extent that the Distribution (or a part of it) is either exempt income or non-assessable non-exempt income in the hands of the relevant Holder, then the amount of any franking credit on the Distribution that is exempt income or non-assessable non-exempt income, is not included in the assessable income of the Holder and the Holder is not entitled to a tax offset under Division 207 of the ITAA 1997 (Subdivision 207-D of the ITAA 1997).

Franking credit subject to the refundable tax offset rules

73. Holders who are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997, in respect of the franking credits received in relation to the WCN 3, will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997, unless they are specifically excluded under section 67-25 of the ITAA 1997.

Imputation benefits – streaming of imputation benefits

74. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received by a Holder in relation to the Distributions.

Section 177EA of the ITAA 1936

75. 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 Holders in relation to the Distributions.

Gross-up and tax offset denied in certain circumstances

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

Each WCN 3 will not be a traditional security

77. Section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of Holders upon disposal of their WCN 3.

78. Section 70B of the ITAA 1936 will not apply to allow a deduction to Holders upon disposal of their WCN 3.

The WCN 3 are convertible interests

79. Each WCN 3 is a convertible interest under item 4 of the table in subsection 974-75(1) of the ITAA 1997.

Conversion of the WCN 3 – ordinary income

80. As the WCN 3 will be held by Holders on capital account, no amount will be included in the assessable income of a Holder on the Conversion of a WCN 3 under section 6-5 of the ITAA 1997.

81. Similarly, Holders will not incur a deductible loss under section 8-1 of the ITAA 1997 as a consequence of a Conversion.

Allotment of Ordinary Shares on Conversion not a dividend

82. Other than in respect of a Distribution paid on the Conversion Date, Conversion of the WCN 3 will not result in Holders being taken to have received a dividend as defined in subsection 6(1) of the ITAA 1936.

Conversion of the WCN 3 – CGT implications

83. CGT event C2 (section 104-25 of the ITAA 1997) will happen for Holders on Conversion of the WCN 3 for Ordinary Shares. Conversion is constituted by the WCN 3 (a convertible interest) being converted into Ordinary Shares.

84. Any capital gain or capital loss made by a Holder from CGT event C2 happening on Conversion of the WCN 3 will be disregarded (subsection 130-60(3) of the ITAA 1997).

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

85. On Conversion of the WCN 3, Subdivision 130-C of the ITAA 1997 will apply so that the first element of the cost base and reduced cost base of each Ordinary Share acquired from Conversion of a WCN 3 will be a pro-rata portion of the cost base of the WCN 3 at the time of Conversion (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of Ordinary Shares on Conversion

86. Ordinary Shares acquired on Conversion of the WCN 3 (being convertible interests) will be taken to be acquired when the Conversion happens on the relevant Conversion Date (subsection 130-60(2) of the ITAA 1997).

Redemption or Transfer of the WCN 3 – ordinary income

87. As the WCN 3 will be held by Holders on capital account, no amount will be included in the assessable income of a Holder on the Redemption or Transfer of a WCN 3 under section 6-5 of the ITAA 1997.

88. Similarly, Holders will not incur a deductible loss under section 8-1 of the ITAA 1997 as a consequence of Redemption or Transfer of their WCN 3.

Redemption of the WCN 3 – CGT implications

89. CGT event C2 (section 104-25 of the ITAA 1997) will happen on the Redemption of the WCN 3. Redemption is constituted by the redemption of all or some of the WCN 3 for their Face Value.

90. As the capital proceeds received by Holders will not be more than the cost base of the WCN 3, Holders should not make a capital gain as a result of the Redemption of their WCN 3 under the scheme.

91. If the Face Value of the WCN 3 has been reduced because there has been a Capital Trigger Event or a Non-Viability Trigger Event, Holders will make a capital loss on the Redemption of their WCN 3.

Transfer of the WCN 3 – CGT implications

92. CGT event A1 (section 104-10 of the ITAA 1997) will happen on the Transfer of the WCN 3. The Transfer of the WCN 3 will be for the Face Value of the WCN 3.

93. As the capital proceeds received by Holders will not be more than the cost base of the WCN 3, Holders should not make a capital gain as a result of the Transfer of their WCN 3 under the scheme.

94. If the Face Value of the WCN 3 has been reduced because there has been a Capital Trigger Event or a Non-Viability Trigger Event, Holders will make a capital loss on the Transfer of their WCN 3.

Application of sections 45, 45A and 45B of the ITAA 1936

Section 45 of the ITAA 1936

95. Section 45 of the ITAA 1936 will not apply to treat the value of the Ordinary Shares issued to the Holders on Conversion as an unfrankable dividend paid by Westpac to the Holders.

Section 45A of the ITAA 1936

96. 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 part of, a capital benefit that arises on Conversion or Redemption of the WCN 3 as an unfranked dividend in the hands of Holders.

Section 45B of the ITAA 1936

97. 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 part of, a capital benefit that arises on Conversion or Redemption of the WCN 3 as an unfranked dividend in the hands of Holders.

Commissioner of Taxation
19 August 2015

Appendix 1 – Explanation

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

Acquisition of the WCN 3 – CGT implications

Acquisition time of the WCN 3

98. 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 of the ITAA 1997).

99. A Holder will acquire their WCN 3 on the Issue Date, being the date the WCN 3 is issued. Accordingly for the purposes of item 2 in the table contained in section 109-10 of the ITAA 1997, the WCN 3 will be acquired on 8 September 2015.

Cost base and reduced cost base of the WCN 3

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

101. The issue price of each WCN 3 is $100. Accordingly, when the WCN 3 are issued, the first element of the cost base and reduced cost base of each WCN 3 is $100.

Inclusion of Distributions and franking credits in assessable income

102. Paragraph 44(1)(a) of the ITAA 1936 provides that the assessable income of a resident shareholder in a company includes all dividends and non-share dividends paid to the shareholder by the company.

103. The WCN 3 are a 'non-share equity interest' as defined in subsection 995-1(1) of the ITAA 1997 and each of the Holders is an 'equity holder' 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 governs dividends) applies to a non-share equity interest in the same way as it applies to a share. 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.

104. Distributions paid in respect of non-share equity interests are non-share distributions pursuant to section 974-115 of the ITAA 1997.

105. The Distributions will not be debited against Westpac's non-share capital account or share capital account. Therefore, Distributions paid in respect of the WCN 3 are non-share dividends under section 974-120 of the ITAA 1997. Accordingly, Holders must include in their assessable income Distributions paid in respect of the WCN 3 under subparagraph 44(1)(a)(ii) of the ITAA 1936.

106. Distributions are expected to be franked. In accordance with subsection 207-20(1) of the ITAA 1997, any franking credit attached to a Distribution must also be included in the relevant Holder's assessable income for the income year in which the Distribution is made.

Entitlement to a tax offset

107. In accordance with subsection 207-20(2) of the ITAA 1997, Holders 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.

Exempt income or non-assessable non-exempt income

108. To the extent that the Distribution is exempt income or non-assessable non-exempt income in the hands of the Holder and none of the exceptions in Subdivision 207-E of the ITAA 1997 apply, then the amount of any franking credit on the Distribution that is exempt income or non-assessable non-exempt income, is not included in the assessable income of the Holder and the Holder is not entitled to a tax offset under Division 207 of the ITAA 1997 (Subdivision 207-D of the ITAA 1997).

Franking credit subject to the refundable tax offset rules

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

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

111. Entities excluded under section 67-25 of the ITAA 1997 include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions as set out in subsections 67-25(1C) or 67-25(1D) of the ITAA 1997.

Imputation benefits – streaming of imputation benefits

112. Subdivision 204-D of the ITAA 1997 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.

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

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

114. If all the conditions in subsection 204-30 are satisfied, the Commissioner may make one or more of the following determinations listed under subsection 204-30(3) of the ITAA 1997:

- that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member
- that a specified exempting debit arises in the exempting account of the entity, for a specified distribution or other benefit to a disadvantaged member
- that no imputation benefit is to arise in respect of a distribution that is made to a favoured member and specified in the determination.

115. The meaning of the word 'streams' is not defined for the purposes of Subdivision 204-D of the ITAA 1997. 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*).

116. Westpac has indicated that all Holders will receive franked Distributions regardless of their tax attributes or their individual tax position. Westpac's policy in relation to the franking of its frankable distributions is not expected to change as a result of the issue of the WCN 3.

117. Foreign residents will not be precluded from participating in the offer, where the offer is made in accordance with the laws of their jurisdiction.

118. The Ordinary Shares allotted on Conversion of the WCN 3 will not attract the application of section 204-30 of the ITAA 1997. This is because the issue of Ordinary Shares does not constitute a distribution as defined in section 960-120 of the ITAA 1997 and the allotment of Ordinary Shares will not affect Westpac's dividend franking policy.

119. Based on the information provided, the Commissioner has concluded that the requisite element of streaming does not exist in relation to the franked distributions to be paid by Westpac to Holders. Accordingly, the Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received by a Holder in relation to Distributions paid in respect of the WCN 3.

Section 177EA of the ITAA 1936

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

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

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

(a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity, and

(b) either:

  (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests, or

(ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be, and

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

(d) except for this section, the person (the relevant taxpayer) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution, and

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

122. Subsection 177EA(12) of the ITAA 1936 extends the operation of section 177EA of the ITAA 1936 to non-share equity interests. 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.

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

(a) the issue of the WCN 3 constitutes a scheme for the disposition of a membership interest (paragraph 177EA(3)(a) of the ITAA 1936). Pursuant to paragraph 177EA(14)(a) of the ITAA 1936, ‘a scheme for a disposition of membership interests or an interest in membership interests’ includes a scheme that involves issuing membership interests. Paragraph 177EA(12)(a) of the ITAA 1936 applies to treat non-share equity interests the same way as ‘membership interests’ under section 177EA of the ITAA 1936. The WCN 3 are non-share equity interests. Therefore, the Westpac Capital Notes 3 will be treated as ‘membership interests’ issued by Westpac for the purposes of paragraph 177EA(3)(a) of the ITAA 1936

(b) frankable distributions are expected to be payable to the Holders in respect of the membership interest (paragraph 177EA(3)(b) of the ITAA 1936). The Commissioner accepts that Distributions payable on the WCN 3 will be frankable distributions under section 202-40 of the ITAA 1997

(c) franked distributions are expected to be paid to the Holders (paragraph 177EA(3)(c) of the ITAA 1936). It is expected that Westpac will continue its policy of fully franking all frankable distributions made by it, and

(d) it is reasonable to expect that an imputation benefit will be received by the Holders (that is, the relevant taxpayers), given that Westpac expects to frank the Distributions on the WCN 3 (paragraph 177EA(3)(d) of ITAA 1936).

124. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme, did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer (Holders) to obtain an imputation benefit (paragraph 177EA(3)(e) of the ITAA 1936).

125. Circumstances which are relevant in determining whether any person has the requisite purpose include, but are not limited to, the factors listed in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed encompass a range of circumstances which taken individually or collectively could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may or may not be present at any one time in relation to a particular scheme.

126. Based on the information provided and the qualifications set out in this Ruling, and having regard to all the relevant circumstances of the scheme, the Commissioner has concluded that the purpose of enabling the Holders to obtain imputation benefits is not more than incidental to Westpac's purpose of raising Tier 1 Capital to meet its capital adequacy requirements.

127. 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 received by Holders in relation to Distributions.

Gross-up and tax offset denied in certain circumstances

128. Subdivision 207-F of the ITAA 1997 creates the appropriate adjustment to cancel the effect of the gross-up and tax offset rules where the entity concerned has manipulated the imputation system in a manner that is not permitted under the income tax law.

129. Section 207-145 of the ITAA 1997 provides the circumstances that must exist before this adjustment can occur. Pursuant to subsection 207-145(1) of the ITAA 1997 a 'manipulation of the imputation system' may occur where 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) of the ITAA 1997)
- the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(b) of the ITAA 1997)
- the Commissioner has made a determination under paragraph 204-30(3)(c) of the ITAA 1997 that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(c) of the ITAA 1997), or
- the distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d) of the ITAA 1997).

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

131. By virtue of former section 160AOA of the ITAA 1936, the holding period rule and the related payments rule apply to non-share equity interests, equity holders and non-share dividends in the same way as they apply to shares, shareholders and dividends respectively.

132. The holding period rule applies where neither the holder nor an associate of the holder has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend (or non-share dividend), and requires the shares (or non-share equity interests) to have been continuously held at risk throughout the primary qualification period (former paragraph 160APHO(1)(a) of the ITAA 1936).

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

134. A Holder will be a 'qualified person' in relation to a Distribution received, provided that:

- the Holder held their WCN 3 at risk for a period of at least 90 days (excluding the day of acquisition and the day of disposal, and any days on which the Holder has materially diminished risks of loss or opportunities for gain in respect of the shares or interest), in the period beginning on the day after the day on which the Holder acquired the WCN 3 and ending on the 90th day after the day on which the WCN 3 became ex-dividend (former subsections 160APHO(2) and 160APHO(3) of the ITAA 1936 and former sections 160APHM and 160APHJ of the ITAA 1936), and
- neither the Holder, nor an associate of the Holder, has made, is under an obligation to make, or are likely to make a related payment in relation to Distributions on their WCN 3 (former paragraph 160APHO(1)(a) of the ITAA 1936 and former section 160APHN of the ITAA 1936).

135. If either, or both, of the above two considerations are not met, the Holders will not be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.

136. In determining whether a shareholder is a 'qualified person' in relation to dividends paid on their shares, all 'positions' in respect of the shares are taken into account in identifying a 'net position' to ensure that there is no material diminution in the risks of loss or opportunities for gain.

137. The Commissioner has concluded that the Transfer and Conversion mechanisms in relation to the WCN 3 will not of themselves affect a Holder's risks of loss or opportunities for gain in respect of the WCN 3. Therefore, paragraph 207-145(1)(a) of the ITAA 1997 does not apply.

138. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Distributions paid to Holders.

139. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to paragraph 207-145(1)(d) of the ITAA 1997, where the distribution arose out of, or was made in the course of, a scheme or substantially similar arrangement that was in the nature of dividend stripping.

140. The Prospectus and Terms provide no indication that the offering of the WCN 3 and the associated payment of franked Distributions to Holders in any way constitutes a dividend stripping arrangement.

141. Accordingly, section 207-145 of the ITAA 1997 will not apply to adjust the Holders' assessable income to exclude the franking credit on the Distributions, nor will it deny the tax offset to which the Holders would otherwise be entitled.

Each WCN 3 will not be a traditional security

142. 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 the definition of traditional security in subparagraph 26BB(1)(b)(ii) of the ITAA 1936.

143. 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.

144. The WCN 3 is not stock, a bond, debenture, certificate of entitlement, bill of exchange, or a promissory note.

145. 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 securities referred to in paragraph (a) of the definition of security will generally be recognised as debt instruments (Taxation Ruling TR 96/14).

146. Paragraphs (b) and (c) of the definition of security do not apply because the WCN 3 is neither a deposit with a bank or other financial institution, nor a secured or unsecured loan.

147. Only those contracts that have debt like obligations will usually fall under paragraph (d) of the definition of security (TR 96/14).

148. The Terms do not evidence a liability by Westpac to pay an amount or amounts to Holders of the WCN 3 at a particular time.

149. The WCN 3 are perpetual and Holders do not have a right to require Redemption.

150. The payment by Westpac of Distributions is subject to the payment conditions in clause 3.3 of the Terms. Distributions are discretionary and non-cumulative. If a Distribution is not paid, Westpac has no liability to pay the Distribution and Holders have no claim in respect of non-payment.

151. Upon Conversion, Westpac will allot and issue a number of Ordinary Shares based on a formula set out in the Terms for each WCN 3 held by the Holder. Each Holder's rights in relation to each WCN 3 that is being converted are immediately and irrevocably terminated for an amount equal to the Face Value and Westpac will apply that amount by way of payment for the subscription for Ordinary Shares issued to Holders. Westpac cannot be said to have a liability to pay an amount under the Terms of the WCN 3 pursuant to the Conversion.

152. Early Redemption of the WCN 3 is possible. However it is at the option of Westpac and will only occur upon the happening of certain events and requires the prior written approval of APRA. This does not establish a liability on Westpac to pay an amount.

153. Westpac would not become liable to pay an amount under the WCN 3 upon a wind-up if, as it would be expected, before a wind-up commences, the WCN 3 are either converted into Ordinary Shares pursuant to a Capital Trigger Event or a Non-Viability Trigger Event (in which case any distribution would be made to the Holders as ordinary shareholders as opposed to under the terms of the WCN 3), or Holders' rights are terminated where Westpac is not able to issue Ordinary Shares within the time stated in the Terms.

154. The Terms do not exhibit a debt like obligation as contemplated by paragraph (d) of the definition of 'security'.

155. As the WCN 3 is not a security within the meaning of subsection 159GP(1) of the ITAA 1936, it cannot be a traditional security under subsection 26BB of the ITAA 1936.

156. Accordingly section 26BB of the ITAA 1936 will not apply to include any gain upon disposal or redemption of the WCN 3 in the assessable income of the Holder. Section 70B of the ITAA 1936 will not apply to allow a deduction to Holders upon disposal and redemption of their WCN 3.

The WCN 3 are convertible interests

157. Subsection 995-1(1) of the ITAA 1997 defines a 'convertible interest' in a company as an interest of the kind referred to in item 4 of the table in subsection 974-75(1) of the ITAA 1997. Paragraph (b) of item 4 of the table in subsection 974-75(1) provides that an interest is an equity interest if it is an interest issued by the company that is an interest that will, or may, convert into an equity interest in the company.

158. Under section 974-165 of the ITAA 1997, an interest is an interest that will or may convert into another interest if:

- the interest must be or may be converted into another interest (paragraph 974-165(a) of the ITAA 1997)
- the interest must be or may be redeemed, repaid or satisfied by the issue or transfer of the other interest (subparagraph 974-165(b)(i) of the ITAA 1997).

159. Each WCN 3 is a convertible interest because it will or may be redeemed, repaid or satisfied by the issue of Ordinary Shares upon Conversion.

Conversion of the WCN 3 – ordinary income

160. Section 6-5 of the ITAA 1997 provides that assessable income includes income according to ordinary concepts, otherwise known as ordinary income.

161. Subsection 6-10(2) of the ITAA 1997 also includes in assessable income amounts of statutory income, that is, amounts that are not ordinary income but are included in assessable income by the income tax legislation. Statutory income includes net capital gains (sections 10-5 and 102-5 of the ITAA 1997).

162. The WCN 3 will be held by Holders on capital account as the Holders will acquire a CGT asset pursuant to item 2 in section 109-10 of the ITAA 1997. Accordingly, any capital gain will be statutory income, and no amount will be included in the assessable income of a Holder on the Conversion of a WCN 3 under section 6-5 of the ITAA 1997.

163. Similarly, Holders will not be entitled to a deductible loss under section 8-1 of the ITAA 1997 in respect of the Conversion of their WCN.

Allotment of Ordinary Shares on Conversion not a dividend

164. On Conversion, Westpac will debit the Face Value of the WCN 3 to its non-share capital account. Accordingly, the issue of Ordinary shares on Conversion is not a non-share dividend and will not be included in assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

Conversion of the WCN 3 – CGT implications

165. CGT event C2 will happen to Holders on Conversion of the WCN 3. Under paragraph 104-25(1)(f) of the ITAA 1997, CGT event C2 happens if an entity's ownership of an intangible CGT asset ends by the asset (if it is a convertible interest) being converted.

166. The WCN 3 are convertible interests. Conversion of the WCN 3 for Ordinary Shares constitutes the conversion of a convertible interest.

167. Conversion of the WCN 3 happens as part of a conversion to which Subdivision 130-C of the ITAA 1997 applies. Under subsection 130-60(3) of the ITAA 1997, a capital gain or capital loss made from converting a convertible interest is disregarded. Any capital gain or capital loss made by a Holder from CGT event C2 happening on Conversion of the WCN 3 will be disregarded.

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

168. On Conversion, Subdivision 130-C of the ITAA 1997 will apply so that the first element of the cost base and reduced cost base of each Ordinary Share acquired from Conversion of a WCN 3 will be a pro-rata portion of the cost base of their WCN 3 at the time of Conversion (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of Ordinary Shares acquired on Conversion

169. Ordinary Shares acquired on Conversion of the WCN 3 (being convertible interests) will be taken to be acquired when the Conversion happens on the relevant Conversion Date (subsection 130-60(2) of the ITAA 1997).

Redemption or Transfer of the WCN 3 – ordinary income

170. The WCN 3 will be held by Holders on capital account. Accordingly, no amount will be included in the assessable income of a Holder on the Redemption or Transfer of a WCN 3 under section 6-5 of the ITAA 1997.

171. Similarly, Holders will not be entitled to a deductible loss under section 8-1 of the ITAA 1997 in respect of a Redemption or Transfer of their WCN 3.

Redemption of the WCN 3 – CGT implications

172. CGT event C2 (section 104-25 of the ITAA 1997) will happen on the Redemption of the WCN 3. Under paragraph 104-25(1)(a) of the ITAA 1997, CGT event C2 happens if an entity's ownership of an intangible CGT asset ends by the asset being redeemed or cancelled.

173. On Redemption, a Holder's ownership of the WCN 3 (being an intangible CGT asset) will end by being redeemed for an amount equal to its Face Value.

174. As the capital proceeds received by Holders will not be more than the cost base of the WCN 3, Holders should not make a capital gain as a result of the Redemption of their WCN 3 under the scheme.

175. If the Face Value of the WCN 3 has been reduced because there has been a Capital Trigger Event or a Non-Viability Trigger Event, Holders will make a capital loss on the Redemption of their WCN 3 under subparagraph 104-25(3) of the ITAA 1997.

Transfer of the WCN 3 – CGT implications

176. CGT event A1 (section 104-10 of the ITAA 1997) will happen on the Transfer of the WCN 3. Under section 104-10 of the ITAA 1997, CGT event A1 happens if there is a disposal of a CGT asset. You dispose of a CGT asset if a change of ownership occurs from you to another entity (subsection 104-10(2) of the ITAA 1997).

177. The Transfer of the WCN 3 constitutes a disposal of a CGT asset as it results in the transfer of the ownership of the WCN 3 from the Holder to the Nominated Party.

178. As the capital proceeds received by Holders will not be more than the cost base of the WCN 3, Holders should not make a capital gain as a result of the Transfer of their WCN 3 under the scheme.

179. If the Face Value of the WCN 3 has been reduced because there has been a Capital Trigger Event or a Non-Viability Trigger Event, Holders will make a capital loss on the Transfer of their WCN 3 under subparagraph 104-25(3) of the ITAA 1997.

Application of sections 45, 45A and 45B of the ITAA 1936

180. The WCN 3 are a 'non-share equity interest' as defined in subsection 995-1(1) of the ITAA 1997 and each of the Holders are an 'equity holder' 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 sections 45, 45A and 45B) applies to a non-share equity interest in the same way as it applies to a share. 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.

Section 45 of the ITAA 1936

181. 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 franked to less than 10%.

182. Westpac expects to pay fully franked dividends to all its shareholders and fully franked distributions to all its holders of non-share equity interests.

183. 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 value of Ordinary Shares on Conversion as an unfrankable dividend in the hands of the Holders.

Section 45A of the ITAA 1936

184. 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 (the advantaged shareholders) and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

185. Where the Commissioner makes a written 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 capital benefits will be treated as unfranked dividends paid out of the company's profits.

186. The issue of Ordinary Shares to Holders on Conversion will constitute the provision of capital benefits pursuant to paragraph 45A(3)(a) of the ITAA 1936.

187. In the absence of any other factors that would contribute to an alternative conclusion, the issue of Ordinary Shares on Conversion will not be considered to be streaming the provision of capital benefits.

188. The Redemption will involve the provision of a capital benefit within the meaning of subsection 45A(3)(b) of the ITAA 1936 (by virtue subsection 45A(3A) of the ITAA 1936) as it will constitute a non-share capital return. The amount paid to Holders on Redemption is limited to the amount of the Face Value of the WCN 3 and any Distribution entitlements on the WCN 3 will be separately paid as Distributions given that the Redemption Date will also be a Distribution Payment Date under the Terms.

189. Accordingly, it cannot be said that Holders would derive a greater benefit from capital benefits than other Westpac shareholders.

190. 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 Holders when the Ordinary Shares are issued to the Holders on Conversion or Redemption.

Section 45B of the ITAA 1936

191. Subsection 45B(1) of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends and the conditions in subsection 45B(2) of the ITAA 1936 are met.

192. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, paragraph 45B(3)(b) of the ITAA 1936 empowers the Commissioner to make a determination that section 45C of the ITAA 1936 applies such that the capital benefit is taken to be an unfranked dividend.

193. The issue of Ordinary Shares to Holders on Conversion will constitute a scheme under which the Holders are provided with a capital benefit by Westpac (paragraph 45B(5)(a) of the ITAA 1936). Similarly, Redemption will also constitute a scheme under which the Holders are provided with a capital benefit by Westpac (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).

194. For the provision to apply, among other things, 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.

195. Having regard to the relevant circumstances of the scheme, it cannot be concluded that Westpac, the Holders or any other person entered into or carried out any part of the scheme did so for more than an incidental purpose of enabling Holders to obtain a tax benefit.

196. 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 Holders when Ordinary Shares are issued to the Holders on Conversion or Redemption.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/14; TR 2006/10

Subject references:
- acquisition dates
- anti-avoidance measures
- capital gains tax
- CGT cost base
- dividend imputation
- qualified persons

Legislative references:
- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 26BB
- ITAA 1936 26BB(1)
- ITAA 1936 26BB(1)(b)(ii)
- ITAA 1936 26C
- ITAA 1936 43B(1)(a)
- ITAA 1936 43B(1)(b)
- ITAA 1936 44(1)
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- ITAA 1936 45
- ITAA 1936 45A
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- ITAA 1936 45A(3)
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- ITAA 1936 45A(3A)
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- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(c)
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- ITAA 1936 45B(5)(a)
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- ITAA 1936 70B
- ITAA 1936 159GP(1)
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- ITAA 1936 177EA(17)
- ITAA 1997
- ITAA 1997 6-5
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- ITAA 1997 10-5
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- ITAA 1997 67-25
- ITAA 1997 67-25(1C)
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- ITAA 1997 102-5
- ITAA 1997 104-10
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- ITAA 1997 104-25
- ITAA 1997 104-25(1)(f)
- ITAA 1997 104-25(3)
- ITAA 1997 109-10
- ITAA 1997 110-25(2)
- ITAA 1997 110-25(2)(a)
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- ITAA 1997 130-60(2)
- ITAA 1997 130-60(3)
- ITAA 1997 Div 197
- ITAA 1997 202-40
- ITAA 1997 Subdiv 204-D
- ITAA 1997 204-30
- ITAA 1997 204-30(1)(a)
- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 Div 207
- ITAA 1997 Subdiv 207-D
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- ITAA 1997 Subdiv 207-F
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- ITAA 1997 207-20(2)
- ITAA 1997 207-145
- ITAA 1997 207-145(1)
- ITAA 1997 207-145(1)(a)
- ITAA 1997 207-145(1)(b)
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- ITAA 1997 215-20
- ITAA 1997 Div 230
- ITAA 1997 Div 974
- ITAA 1997 974-75(1)
- ITAA 1997 974-75(1)(b)
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- ITAA 1997 974-165
- ITAA 1997 974-165(a)
- ITAA 1997 974-165(b)(i)
- ITAA 1997 995-1(1)
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Other references:

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

ATO references

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ATOlaw topic: Income tax ~~ Assessable income ~~ Dividend, interest and royalties ~~ Dividend income
Income tax ~~ Assessable income ~~ Dividend, interest and royalties ~~ Interest income
Income tax ~~ Assessable income ~~ Other types of income ~~ Traditional securities
Income tax ~~ Capital gains tax ~~ CGT assets ~~ General
Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events C1 to C3 - end of a CGT asset
Tax offsets, credits and benefits ~~ Other offsets and credits ~~ Franking tax offset
Tax offsets, credits and benefits ~~ Other offsets and credits ~~ Dividend streaming and demerger benefits