



CR 2006/68 - Income tax: capital gains: Step-up Preference Shares: St George Bank Limited

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Class Ruling

Income tax: capital gains: Step-up Preference Shares: St George Bank Limited

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

What this Ruling is about

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

Relevant provision(s)

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

- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 104 of the ITAA 1997;
- section 104-155 of the ITAA 1997;
- section 109-10 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- section 130-20 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997;

- section 207-145 of the ITAA 1997;
- subsection 6(1) of the Income *Tax Assessment Act* 1936 (ITAA 1936);
- section 6BA of the ITAA 1936;
- subsection 44(1) of the ITAA 1936;
- section 46H of the ITAA 1936; and
- section 177EA of the ITAA 1936.

Class of entities

3. The class of entities to which this Ruling applies is the Australian resident investors (referred to as Holders) who were allotted non-cumulative unsecured preference shares by St. George Bank Limited (SGBL) called Step-up Preference Shares (SPS).
4. The class of entities to which this Ruling applies does not include investors in the SPS who acquired them otherwise than by subscription. The Ruling does not deal with how the taxation law applies to SGBL in relation to the issue of the SPS.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.
6. 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 14 to 40 of this Ruling.
7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
 - this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.
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Date of effect

9. This Ruling applies from 20 June 2006. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

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

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

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

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

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

Withdrawal

13. This Ruling is withdrawn on and ceases to have effect after 30 June 2009. The Ruling continues to apply in respect of the relevant provisions ruled upon to all entities within the specified class who entered into the specified scheme during the term of the Ruling. Thus the Ruling continues to apply to those entities, even following its withdrawal, for the scheme entered into prior to the withdrawal of the Ruling. This is subject to there being no change in the scheme or in the entities' involvement in the scheme.

Scheme

14. The scheme that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or the relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- the application for a Class Ruling dated 19 May 2006 and appendices from Greenwoods & Freehills;
- the Constitution of SGBL dated 19 December 2003; and
- SPS Prospectus dated 31 May 2006, including the Terms of Issue contained in Appendix A of that document.

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

15. On 20 June 2006 SGBL allotted 1.5 million SPS to Australian resident retail and institutional investors. The SPS were issued pursuant to a Prospectus dated 31 May 2006. The SPS offer opened on 8 June 2006 and closed at 10.00am on 16 June 2006. The SPS were issued as fully paid at \$100 face value for each SPS. The issue raised \$150 million.

16. The issuance of SPS forms part of SGBL's on-going capital management program, with the proceeds from the issue intended to be used to enhance SGBL's overall capital position and to fund ongoing growth in its business. SGBL has advised that proceeds raised from the issue of SPS satisfy the Tier 1 capital requirements as established by the Australian Prudential Regulation Authority (APRA) and, hence, will increase SGBL's Tier 1 Capital Ratio.

17. The SPS are listed on the Australian Stock Exchange.

18. The SPS are unsecured perpetual securities that have no set maturity. Holders of SPS are entitled to receive a preferred non-cumulative floating rate Dividend payable in arrears on each Dividend Payment Date.

19. Dividend Payment Date is relevantly defined in the SPS Terms of Issue (the Terms) as '[20 August] and thereafter each 20 November, 20 February, 20 May and 20 August until SPS are Exchanged, in which case the Exchange Date will constitute a Dividend Payment Date, whether or not a Dividend is, or is able to be paid on that date.'

20. The Dividend is calculated as follows:

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

The *Dividend Rate* (expressed as a percentage per annum) is calculated as follows:

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

Where:

Market rate (expressed as a percentage per annum) means, for each Dividend Period, the Bank Bill Swap Rate applying on the first Business Day of each Dividend Period;

Margin (expressed as a percentage per annum) means for the period:

- (a) up to the Increased Margin Date, the Initial Margin (being 1.10% per annum); and
- (b) commencing on and from the Increased Margin Date (being 20 August 2016), the Initial Margin plus 1.00% per annum;

Tax Rate (expressed as a decimal) means the Australian corporate tax rate applicable, which will be taken to be 0.30; and

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

21. An Optional Dividend is a Dividend which has been paid to the Holders of SPS equal to the aggregate amount of any unpaid Dividends which were scheduled to be paid in the 12 months before the date of payment of the Optional Dividend.

22. Payment of a Dividend, including any Optional Dividend, is subject to the following conditions:

- (a) the Directors, at their sole discretion, declaring the Dividend or Optional Dividend to be payable;
- (b) SGBL having profits available for the payment;
- (c) SGBL complying with APRA's capital adequacy guidelines in respect of Capital ratios maintained, unless APRA gives its prior written approval;
- (d) the amount of the Dividend or Optional Dividend not exceeding the profits after tax of the Group calculated before any dividend or interest payments on Capital Securities which are included in the Group's Upper Tier 2 Capital or Tier 1 Capital for the immediately preceding Reporting Year less the aggregate amount of dividends paid or interest paid or payable by a member of the Group on its Capital Securities included in its Upper Tier 2 Capital or Tier 1 Capital in the 12 months up to the Record Date for the Dividend or

Optional Dividend, unless APRA gives its prior written approval; and

- (e) in the case of an Optional Dividend, APRA gives its prior written approval.

23. Further, Directors will not declare a Dividend or Optional Dividend if, in their opinion, making the payment would result in SGBL becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*.

24. SPS Dividends are non-cumulative. Accordingly, non-payment of all or part of a declared Dividend does not constitute an event of default by SGBL, and Holders have no claim in respect of such non-payment.

25. SGBL expects to fully frank the Dividends and Optional Dividends payable on SPS. The Terms further provide for an adjustment mechanism to increase Dividend payments in the event that the Dividends paid are unfranked or only partially franked.

26. If SGBL does not declare a Dividend, or pay a Dividend which has previously been declared, within 20 Business Days after the relevant Dividend Payment Date, then SGBL must not, without approval of a Special Resolution, declare or pay a dividend or make any distributions in respect of certain equal or junior ranking capital securities, or redeem, reduce, cancel or buy-back any junior ranking capital securities (including Ordinary Shares), until four subsequent consecutive Dividends scheduled to be paid on SPS have been paid in full or an Optional Dividend has been paid to Holders of SPS or there is a payment in respect of the dividend, distribution, redemption, reduction, cancellation or buy-back made pro rata on SPS and on equal ranking capital securities or all SPS have been converted, redeemed, cancelled or bought back.

27. SGBL, at its discretion and subject to APRA approval where required, may elect to exchange the SPS by issuing an Issuer Exchange Notice to the Holders in respect of some or all of their SPS during the period of at least 30 business days (but no more than three months) before a Fixed Exchange Date, being 20 August 2016 or any subsequent Dividend Payment Date as notified in the Exchange Notice, or in respect of all SPS at any time following the occurrence of certain events.

28. SGBL may elect to exchange the SPS in one or a combination of the following ways:

- (a) the conversion of the SPS into Ordinary Shares;
- (b) the redemption of the SPS for cash equal to the face value, being \$100;
- (c) the cancellation of the SPS for cash equal to the face value, being \$100; or
- (d) the buy-back of the SPS for cash equal to the face value, being \$100.

29. If SGBL elects to exchange SPS by 'conversion' (as defined under clause 3.3 of the Terms), the rights and status attaching to SPS under the Terms are varied such that each SPS will have all the rights and status attaching to one fully paid Ordinary Share in SGBL, and will rank equally with all other Ordinary Shares on issue. All prior rights and restrictions conferred on SPS will cease to have effect.

30. In addition, if SGBL elects to exchange the SPS by 'conversion', then upon the conversion event:

- (a) each SPS will convert into one fully paid Ordinary Share (as described above); and
- (b) each Holder will be allotted an additional number of fully paid Ordinary Shares for each SPS that is being converted, in accordance with a formula set out in clause 3.4 of the Terms.

31. Clause 3.3 of the Terms states that the election by SGBL to convert the SPS does not constitute a redemption, cancellation or buy-back of a SPS, nor does it constitute an issue, allotment or creation of a new share (other than any additional Ordinary Shares allotted under clause 3.4 of the Terms).

32. The total number of SGBL Ordinary Shares issued upon conversion of each SPS is capped at the Maximum Conversion Number, which is equal to 400 Ordinary Shares, subject to clauses 3.6 to 3.10.

33. The total market value of SGBL Ordinary Shares held by a Holder after conversion of the SPS and the allotment of additional Ordinary Shares will be equivalent to the face value of the SPS, plus a premium which may vary according to the circumstances but will be at least 2.5% of the face value of the SPS.

34. Prior to conversion, Holders of SPS generally do not have any voting rights in respect of general meetings held by SGBL, except in limited circumstances affecting the rights of the Holders.

35. SPS rank equally among themselves and are unsecured and subordinated to all depositors and creditors of SGBL. SPS also rank equally with all other equal ranking capital securities (including SAINTS and Depository Capital Securities) in respect of the payment of Dividends or other distributions which have been declared, and in respect of redemption, return of capital, cancellation or buy-back of SPS and payment of declared but unpaid Dividends on a winding up of SGBL.

36. The Holders have no right to require SGBL to repay any of the money paid to subscribe for the SPS.

37. Prior to any conversion, SPS rank ahead of SGBL Ordinary Shares in respect of the payment of dividends.

38. SGBL reserves the right to issue further SPS, preference shares (whether redeemable or not) or other capital securities which rank equally with, behind or ahead of SPS, without such an issue constituting a variation or cancellation of the rights attaching to the existing SPS.

39. This Ruling is made on the basis that:

- (i) throughout the period to which this Ruling applies, the SPS are characterised as equity interests in SGBL under Division 974 of the ITAA 1997;
- (ii) throughout the period to which this Ruling applies, the dividends paid on the SPS will be frankable distributions as defined in section 202-40 of the ITAA 1997;
- (iii) upon exchange of the SPS by conversion into SGBL Ordinary Shares, the additional SGBL Ordinary Shares issued to Holders will be characterised as equity interests under Division 974 of the ITAA 1997;
- (iv) SGBL share capital will not become tainted by an issue of the SPS or the additional SGBL Ordinary Shares issued to Holders upon exchange of the SPS by conversion into SGBL Ordinary Shares;
- (v) SGBL will not debit any part of the dividends on the SPS to a disqualifying account within the meaning of section 46H of the ITAA 1936;
- (vi) the terms and conditions under which the SPS were originally issued will not be altered in any material way during the period to which the Ruling applies; and
- (vii) throughout the period to which this Ruling applies the material supplied to the Commissioner, and taken into account in determining the application of the tax laws discussed in this Ruling, remains an accurate description of all of the activities of SGBL that are a material or relevant consideration in respect of any of those tax laws.

40. This Ruling does not consider the taxation implications of the exchange of SPS by redemption, cancellation or buy-back.

Ruling

Acquisition time of the SPS

41. For capital gains tax purposes, pursuant to section 109-10 of the ITAA 1997, each Holder acquired the SPS on 20 June 2006, the date of allotment.

Cost base and reduced cost base

42. For capital gains tax purposes, pursuant to sections 110-25 and 110-55 of the ITAA 1997, the cost base and reduced cost base of each SPS is \$100.

Inclusion of Dividends in assessable income

43. Holders of SPS must include in their assessable income all Dividends received in respect of their SPS under subsection 44(1) of the ITAA 1936, and an amount equal to the franking credits received on those Dividends under subsection 207-20(1) of the ITAA 1997.

Treatment of imputation benefits attached to Dividends

44. Section 207-145 of the ITAA 1997 will not apply to deny Holders of SPS the imputation benefits attached to Dividends received.

Franking credit subject to the refundable tax offset rules

45. Holders of SPS who are entitled to a tax offset under Division 207 of the ITAA 1997 in respect of franking credits received will also be subject to the refundable tax offset rules in Division 67 of the ITAA 1997, unless specifically excluded under section 67-25 of the ITAA 1997. Such excluded entities will include non-complying superannuation funds or Approved Deposit Funds and corporate tax entities that are not exempt institutions or life insurance companies.

Exchange of SPS by conversion into SGBL Ordinary Shares

46. The conversion of each SPS will not give rise to a CGT event for capital gains tax purposes as the variation of rights attaching to the SPS does not involve a disposal of a CGT asset pursuant to section 104-10 of the ITAA 1997 (CGT event A1), or the cancellation, surrender or similar ending of a CGT asset pursuant to section 104-5 of the ITAA 1997 (CGT event C2).

Allotment of additional SGBL Ordinary Shares not a dividend

47. The allotment of additional SGBL Ordinary Shares on conversion of the SPS will not be assessable as dividend income in the hands of the Holders.

Cost base of the additional Ordinary Shares

48. Either section 6BA of the ITAA 1936 or Subdivision 130-A of the ITAA 1997 will apply to apportion the cost or the cost base of the SPS over the Ordinary Share into which the SPS converts and the additional SGBL Ordinary Shares issued by SGBL on conversion. The additional Ordinary Shares are taken to be acquired at the time the SPS were originally acquired by the Holders, being 20 June 2006.

CGT event H2 does not apply to the Holders on conversion

49. The conversion of SPS into Ordinary Shares under the scheme will not give rise to a CGT event H2 for Holders pursuant to section 104-155 of the ITAA 1997.

The anti-avoidance provisions

Section 204-30

50. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 that denies imputation benefits to Holders in respect of franked distributions paid on the SPS by SGBL.

Section 177EA

51. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 that denies imputation benefits to a Holder in respect of a franked distribution paid on the SPS by SGBL.

Appendix 1 – Explanation

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

Acquisition time of the SPS

52. For capital gains tax purposes, item 2 of the table contained in section 109-10 of the ITAA 1997 provides that where a company issues or allots equity interests in the company, the acquisition time of the equity interest is when the contract is entered into or, if none, when the equity interests are issued or allotted.

53. Under the SPS Prospectus, the SPS offer opened on 8 June 2006 and closed at 10.00am on 16 June 2006. The SPS were subsequently allotted to the Holders on 20 June 2006.

54. The acquisition time of the SPS, for the purposes of item 2 of the table contained in section 109-10 of the ITAA 1997, is the allotment date of 20 June 2006.

55. Subsection 130-60(2) of the ITAA 1997 does not apply to alter this acquisition date for capital gains tax purposes.

SPS cost base and reduced cost base

56. For the purposes of calculating a capital gain or loss on disposal, paragraph 110-25(2)(a) and subsection 110-55(2) of the ITAA 1997 provide that the first element of the cost base and reduced cost base of a CGT asset is the money paid or required to be paid in respect of acquiring the asset.

57. Accordingly, the first element of the cost base and reduced cost base of each SPS is \$100.

Inclusion of Dividends in assessable income

58. Subsection 44(1) of the ITAA 1936 requires shareholders in a company to include in their assessable income all dividends paid to them by a company in respect of their shareholding. For Australian resident shareholders, these dividends must be sourced from Australian resident company profits derived from any source.

59. Under the Australian imputation system, where a franked distribution is paid by an Australian resident company to a shareholder, the assessable income of the shareholder must also include the franking credit attached to the dividend under section 207-20 of the ITAA 1997. The inclusion of both the dividend and the associated franking credit in a shareholder's assessable income is termed 'grossing-up' the dividend receipt.

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

61. SGBL proposes to pay fully franked Dividends to Holders in respect of their SPS. Accordingly, all Holders of SPS must include in their assessable income the amount of the Dividends received, and the amount of associated franking credits attached to those Dividends. Holders of SPS will be entitled to receive a tax offset equal to the value of the franking credits included in their assessable income in respect of their SPS.

Treatment of imputation benefits attached to Dividends

62. Section 207-145 of the ITAA 1997 provides that in circumstances where a franked dividend is paid to an entity (including an individual, a company or a superannuation fund), the gross-up and associated tax offset available to shareholders in respect of the attached franking credit are denied where the receipt constitutes a 'manipulation of the imputation system'.

63. Pursuant to subsection 207-145(1) of the ITAA 1997 a 'manipulation of the imputation system' may occur where:

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

64. A 'qualified person' is defined in section 995-1 of the ITAA 1997 and means a person who satisfies the holding period rule and the related payments rule under Division 1A of Part IIIA of the ITAA 1936.

65. Provided that the Holders:

- have taken no positions (apart from the holding of the SPS) in relation to their SPS;
- hold their SPS for a period of at least 90 days (excluding the day of acquisition and disposal) as required under sections 160APHO and 160APHM of the ITAA 1936; and

- neither the Holder, nor an associate of the Holder, has made or is under an obligation to make, or is likely to make, a related payment within the meaning of section 160APHN of the ITAA 1936 in respect of a Dividend,

the Holders will be taken to be 'qualified persons' as defined in section 995-1 of the ITAA 1997.

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

67. Pursuant to section 207-155 of the ITAA 1997, a distribution will be taken to be made as part of a dividend stripping operation where the distribution arose out of, or was made in the course of, a scheme or substantially similar arrangement that was in the nature of dividend stripping. The Terms, as provided by SGBL, provide no indication that the offering of SPS and the associated payment of franked Dividends to the Holders in any way constitute a dividend stripping arrangement. As such, the dividend stripping provision will have no application to Holders of SPS.

68. Accordingly, section 207-145 of the ITAA 1997 will not apply to deny imputation benefits to Holders of SPS as the requisite manipulation of the imputation system in respect of Dividends paid by SGBL does not exist.

Franking credit subject to the refundable tax offset rules

69. Holders of SPS who are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 in respect of the grossing-up of their dividend receipts will also be subject to the refundable tax offset rules contained in Division 67 of the ITAA 1997. Holders will not, however, be subject to the refundable tax offset rules where they are specifically excluded under section 67-25 of the ITAA 1997. The refundable tax offset rules ensure that taxpayers are entitled to a refund, once their available tax offsets have been utilised to reduce any income tax liability to nil.

70. Accordingly, Holders of SPS will be subject to the refundable tax offset rules unless they are listed as specifically excluded entities under section 67-25 of the ITAA 1997. Excluded entities include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions as set out in subsection 67-25(1C) or subsection 67-25(1D) of the ITAA 1997.

Exchange of SPS by conversion into SGBL Ordinary Shares

71. SGBL may exchange SPS by converting them into SGBL Ordinary Shares. Conversion involves a variation of rights attaching to the SPS, and an allotment by SGBL of additional SGBL Ordinary Shares to the Holders.

72. For capital gains tax purposes, the conversion of SPS into Ordinary Shares, and the allotment of additional Ordinary Shares, will not constitute a CGT event. This is because conversion constitutes a mere variation of the rights attaching to the SPS, and does not constitute a disposal, or an ending of ownership, of an asset or part of an asset as required for a CGT event to occur.

73. Shares are comprised of a bundle of rights; however those rights are not separate pieces of property capable of being divided out and held separately. Accordingly, the rights attaching to shares do not constitute individual assets as defined by section 108-5 of the ITAA 1997, but rather combine to make up the ultimate asset, being the share for CGT purposes (refer to Taxation Ruling TR 94/30).

74. Pursuant to section 104-25 of the ITAA 1997, CGT event C2 happens if the ownership of an intangible asset, such as a preference share, ends by the share:

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

75. As the conversion of each SPS into one SGBL Ordinary Share constitutes a mere variation of rights attaching to the SPS, and does not constitute a redemption or cancellation of the share for CGT purposes, there is no occurrence of CGT event C2 under paragraph 104-25(a) of the ITAA 1997. Further, for CGT event C2 to occur in accordance with paragraph 104-25(f) of ITAA 1997, a convertible interest must be converted, and this conversion must bring the ownership of the share to an end. As the Holder's ownership of a SPS does not end by the mere variation of rights attaching to the SPS, CGT event C2, under paragraph 104-25(f) of the ITAA 1997, does not apply.

76. As CGT event C2 does not occur on the conversion of the SPS to Ordinary Shares, Subdivision 130-C of the ITAA 1997 has no effect. This is due to the fact that the operation of Subdivision 130-C of the ITAA 1997 requires the acquisition of an asset through conversion, which does not occur upon conversion of the SPS.

Allotment of additional SGBL Ordinary Shares not a dividend

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

78. Although the additional SGBL Ordinary Shares issued upon conversion will constitute 'property' in the hands of the Holder whose SPS are converted, the allotment of additional shares by SGBL is not a disposition of property in the ordinary meaning of that expression (refer *Ord Forrest Pty Ltd v. FC of T* (1974) 130 CLR 124; 74 ATC 4034; (1974) 4 ATR 230). As there is no disposition there cannot be a distribution of property by SGBL.

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

80. Accordingly, the allotment of additional SGBL Ordinary Shares on conversion of the SPS does not constitute a dividend within the meaning of subsection 6(1) of the ITAA 1936.

Cost base of the additional Ordinary Shares

81. Either section 6BA of the ITAA 1936 or Subdivision 130-A of the ITAA 1997 will apply to apportion the cost or the cost base of the SPS over the Ordinary Shares into which each SPS converts and the additional SGBL Ordinary Shares issued by SGBL on conversion.

82. Section 6BA of the ITAA 1936 applies if a shareholder holds shares in a company (the original shares) and the company issues other shares (the bonus shares) in respect of the original shares.

83. Pursuant to subsection 6BA(3) of ITAA 1936, as the additional SGBL Ordinary Shares are issued to Holders for no consideration and are not a dividend, the issue price of the SPS (being \$100 per SPS) will be apportioned over the Ordinary Shares into which the SPS are converted and any additional SGBL Ordinary Shares allotted on conversion.

84. Subdivision 130-A of the ITAA 1997 applies in a similar manner in respect of shares that are CGT assets. It provides special rules relating to the time of acquisition and the cost base of bonus equities for capital gains tax purposes. Section 130-20 of the ITAA 1997 sets out what happens if an entity owns shares in a company (the original equities) and the company issues other shares (the bonus equities) in relation to the original equities.

85. Pursuant to item 1 of the table in subsection 130-20(3) of the ITAA 1997, as the additional shares are not a dividend, upon conversion of the SPS the cost base is to be apportioned over both the Ordinary Shares into which the SPS convert and any additional Ordinary Shares issued to the Holders by SGBL on conversion.

86. The additional Ordinary Shares are deemed to be acquired at the time when the SPS were originally acquired by the Holders, being 20 June 2006.

CGT event H2 does not apply to the Holders on conversion

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

88. In this case, an act, transaction or event will occur to the SPS on conversion into SGBL Ordinary Shares. However, there will be no CGT event H2 for the Holders because of the applicability of paragraph 104-155(5)(c) of the ITAA 1997, a specific exemption which provides that CGT event H2 does not occur when a company issues or allots equity interests in the company.

89. Where the conversion of the SPS into SGBL Ordinary Shares results in the allotment of additional Ordinary Shares, the cost base of the SPS will be apportioned over the original SPS and the additional Ordinary Shares in accordance with item 1 in the table in subsection 130-20(3) of the ITAA 1997. This will result in an adjustment to the cost base or reduced cost base of the SPS and accordingly will exclude CGT event H2 from applying to the Holders.

The anti-avoidance provisions

Section 204-30

90. Subdivision 204-D of the ITAA 1997 relates to the Commissioner's power to make a determination in circumstances where distributions with attached imputation benefits are streamed to members of a corporate tax entity. An 'imputation benefit' is defined in subsection 204-30(6) of the ITAA 1997 to include, amongst other things, a member's entitlement to a tax offset granted under Division 207 of the ITAA 1997 or a franking credit arising in the franking account of the respective member, as a result of the distribution.

91. Streaming is not defined for the purposes of Subdivision 204-D of the ITAA 1997, however it is understood to refer to a company selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits: refer to paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002. A frankable distribution is a necessary prerequisite for the operation of section 204-30 of the ITAA 1997.

92. Section 204-30 of the ITAA 1997 applies in respect of a company which streams distributions and the giving of other benefits in such a way that some shareholders receive imputation benefits (the favoured members), and other shareholders receive lesser or no imputation benefits (the disadvantaged members) regardless of whether or not they receive other benefits.

93. If section 204-30 of the ITAA 1997 is found to have application, then the Commissioner may make a determination under paragraph 204-30(3)(c) of the ITAA 1997 that no imputation benefit is to arise in respect of the distributions made to those favoured members.

94. For section 204-30 of the ITAA 1997 to apply, there must be a streaming of imputation benefits to advantaged members, who derive a greater benefit from the franking credits received than disadvantaged members. The words 'derives a greater benefit from franking credits' are defined in subsection 204-30(8) of the ITAA 1997 by reference to the ability of members to fully utilise the franking credits received.

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

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

Section 177EA

97. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to schemes seeking to obtain a tax advantage in relation to imputation benefits.

98. Pursuant to subsection 177EA(3) of the ITAA 1936, the streaming provision will apply if:

- (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 section 177EA, 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).

99. It is the payment of a frankable dividend, or frankable distribution which is the essential trigger or pivot on which section 177EA of the ITAA 1936 turns. Without it, there is nothing to bring section 177EA of the ITAA 1936 into play.

100. Pursuant to paragraph 177EA(14)(a) of the ITAA 1936, the meaning of 'scheme for disposition of membership interests or an interest in membership interests' includes a scheme that involves the issuing of membership interests.

101. The issue of SPS and the allotment of additional SGBL Ordinary Shares upon conversion of the SPS would constitute a scheme for disposition of membership interests, thus satisfying paragraph 177EA(3)(a) of the ITAA 1936.

102. The issue of SPS will result in the payment of a frankable distribution to the Holders, which is expected to be fully franked. Accordingly, subparagraph 177EA(3)(b)(i) and paragraph 177EA(3)(c) of the ITAA 1936 are satisfied.

103. Further, paragraph 177EA(3)(d) of the ITAA 1936 is met as SPS Holders would receive, or be reasonably expected to receive, imputation benefits as a result of the distribution.

104. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of SGBL, the Holders or any other relevant party, there is a purpose being more than merely an incidental purpose of conferring an imputation benefit under the scheme. 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.

105. Where section 177EA of the ITAA 1936 applies the Commissioner may make a determination pursuant to paragraph 177EA(5)(b) to deny the imputation benefit to each member.

106. The issue of the SPS is a capital raising transaction which SGBL advises is undertaken to restore SGBL's Tier 1 capital. There is nothing in the Terms which would suggest a tax avoidance purpose, and the arrangement does not result in SGBL avoiding wastage of franking credits.

107. On the basis of the information provided, and having regard to the assumptions and qualifications set out in this Ruling, it would not be reasonable to conclude that in entering into the scheme, the Holder or SGBL demonstrated the objective purpose of securing imputation benefits for the Holders or SGBL. To the extent that any imputation benefits are secured, those benefits are considered to be incidental to the objective purpose of raising Tier 1 capital.

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Not previously issued as a draft

Related Rulings/Determinations:

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Subject references:

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

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