

CR 2006/8 - Income tax: redemption of Preferred Exchangeable Resettable Listed Shares (PERLS) - Commonwealth Bank of Australia

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Class Ruling

Income tax: redemption of Preferred Exchangeable Resettable Listed Shares (PERLS) – Commonwealth Bank of Australia

Contents	Para
BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Withdrawal	9
Scheme	10
Ruling	18
NON BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	25
Appendix 2:	
<i>Detailed contents list</i>	37

📌 This Ruling provides you with the following level of protection:

This publication (excluding appendices) 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 under-paid 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 taxation provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant taxation provision(s)

2. The tax laws dealt with in this Ruling are:

- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- subsection 116-20(1) of the ITAA 1997;
- section 116-30 of the ITAA 1997;
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- subsection 44(1) of the ITAA 1936.

Class of entities

3. The class of entities to which this Ruling applies is those entities that are registered as holders of PERLS as at 6 April 2006, who hold the PERLS on capital account. For the purposes of this Ruling, those entities are referred to as Holders.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. 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 10 to 17.

6. 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

8. This Ruling applies from 6 April 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*;
- the relevant tax laws are not amended.

Withdrawal

9. This Ruling is withdrawn and ceases to have effect after 30 June 2006. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the person's involvement in the scheme.

Scheme

10. The scheme that is the subject of this Ruling is described below. The description incorporates the following documents:

- the application for a Class Ruling dated 13 January 2006 received from Greenwoods & Freehills on behalf of Commonwealth Bank of Australia (the Bank);
- PERLS – Perpetual Exchangeable Resettable Listed Shares: Prospectus (Prospectus); and
- further information received 6 February 2006.

11. In this Ruling, unless otherwise defined, capitalised terms take their meaning as in the Prospectus.

12. On 6 April 2001, the Bank issued 3.5 million PERLS pursuant to the Prospectus. PERLS were issued for their face value of \$200 (the Issue Price). Subsequently, PERLS were able to be acquired on the Australian Stock Exchange (ASX). PERLS represent fully paid up preference shares of the Bank.

13. PERLS carry the right to receive a quarterly dividend, which is fully franked. The PERLS dividend rate is currently 5.6584%. The PERLS dividend rate is determined in accordance with the following formula:

$$\text{Dividend Rate} = \text{Dividend Factor (currently 0.7568)} \times [\text{sum of the Market Rate (the 90 day Bank Bill Rate) and the Margin (currently 1.85\%)}]$$

14. The Bank will redeem the PERLS on 6 April 2006, being a Dividend Repayment Date which occurs on the First Rollover Date (the Redemption).

15. On Redemption, Holders will receive an amount equal to the Issue Price, being \$200, for each PERLS (the Redemption Amount).

16. The Bank will serve an Issuer Exchange Notice at least 21 business days prior to the Redemption. The Issuer Exchange Notice will specify the amount that is paid-up on each PERLS immediately before the redemption (that is \$200).

17. The Redemption Amount will be debited to the Bank's share capital account on the day that PERLS are redeemed (that is, 6 April 2006). The Bank's share capital account is not 'tainted' for the purposes of section 160ARDM of the ITAA 1936.

Ruling

Capital gains tax provisions

18. Capital gains tax (CGT) event C2 will happen under section 104-25 of the ITAA 1997 when the PERLS are redeemed.

19. The time of the CGT event will be 6 April 2006, when the PERLS are redeemed, under subsection 104-25(2) of the ITAA 1997.

20. Pursuant to subsection 104-25(3) of the ITAA 1997, Holders will make a capital gain if the capital proceeds from the Redemption are more than the cost base of the PERLS. They will make a capital loss if the capital proceeds are less than the reduced cost base of the PERLS.

21. The capital proceeds from the Redemption will be \$200 per share under section 116-20 of the ITAA 1997. The market value substitution rule in section 116-30 of the ITAA 1997 will not apply.

22. The first element of the cost base of the PERLS for Holders who subscribed for PERLS via the Prospectus will be \$200 being the Issue Price, under subsection 110-25(2) of the ITAA 1997.

23. The first element of the cost base or reduced cost base of the PERLS for Holders who acquired the PERLS on the ASX will be the acquisition price of the PERLS under subsections 110-25(2) and 110-55(2) of the ITAA 1997. The second element of the cost base or reduced cost base of the PERLS for Holders who acquired the PERLS on the ASX will be the non-deductible incidental costs of acquisition under subsections 110-25(3) and 110-55(2) of the ITAA 1997.

Application of subsection 44(1) of the ITAA 1936

24. Subsection 44(1) of the ITAA 1936 will not apply to assess Holders on the Redemption Amount.

Commissioner of Taxation

1 March 2006

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.*

Capital gains tax provisions

25. Under section 104-25 of the ITAA 1997, CGT event C2 happens when the PERLS are redeemed by the Bank.

26. Pursuant to subsection 104-25(3) of the ITAA 1997, Holders will make a capital gain if the capital proceeds from the Redemption are more than the cost base of the PERLS. They will make a capital loss if the capital proceeds are less than the reduced cost base of the PERLS.

27. The general rules in section 116-20 of the ITAA 1997 will ordinarily determine the capital proceeds to be the total of the money and the market value of any property received. However, under section 116-30 of the ITAA 1997 the capital proceeds from a C2 event will be replaced with the market value of the CGT asset where the capital proceeds are more or less than the market value of the asset.

28. Pursuant to paragraph 116-20(1)(a) of the ITAA 1997, the amount that a Holder receives or is entitled to receive in respect of the redemption of PERLS, will be the capital proceeds. Holders are entitled to receive the Redemption Amount of \$200 for each PERLS. The Commissioner accepts that the market value of the PERLS at the time they are redeemed will be \$200. As the proceeds are equal to the market value of the PERLS, the market value substitution rule in section 116-30 will not apply.

29. Under subsections 110-25(1) and 110-55(1) of the ITAA 1997 the cost base or reduced cost base of the Holders' PERLS consists of five elements.

30. The first element of the cost base of the PERLS for Holders who subscribed for PERLS via the Prospectus will be \$200 being the Issue Price, under subsection 110-25(2) of the ITAA 1997. Where the cost base of the PERLS is equal to the capital proceeds, Holders who acquired PERLS via subscription will make neither a capital gain nor a capital loss on the Redemption of PERLS.

31. The first element of the cost base or reduced cost base of the PERLS for Holders who acquired the PERLS on the ASX will be the acquisition price of the PERLS under subsections 110-25(2) and 110-55(2) of the ITAA 1997. The second element of the cost base or reduced cost base of the PERLS for Holders who acquired the PERLS on the ASX will be the non-deductible incidental costs of acquisition (for example brokerage costs) under subsections 110-25(3) and 110-55(2) of the ITAA 1997.

Application of subsection 44(1) of the ITAA 1936

32. Under subsection 44(1) of the ITAA 1936 the assessable income of a shareholder in a company includes dividends paid to the shareholder out of profits derived by it from any source.

33. The Redemption Amount will constitute a dividend if it satisfies the definition of 'dividend' in subsection 6(1) of the ITAA 1936. The payment of the Redemption Amount will satisfy paragraph (a) of the definition as the payment will constitute a distribution of money by the Bank to certain of its shareholders.

34. However, the Redemption Amount will not constitute a dividend for tax purposes if it satisfies one of the exclusions set out in the definition.

35. Pursuant to the exclusion in paragraph (e), the Redemption amount will not be a dividend as:

- the Redemption Amount is consideration for the Redemption of PERLS;
- the Bank will issue an Issuer Exchange Notice when it redeems PERLS;
- the Issuer Exchange Notice will specify the amount paid up on the share immediately before the Redemption;
- the Redemption Amount will be debited to the Bank's share capital account; and
- the Redemption Amount will be equal to the amount paid up on each PERLS (that is, \$200).

36. As the Redemption Amount does not fall within the definition of dividend in subsection 6(1), subsection 44(1) will not apply to assess the Holders on that amount.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant taxation provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	8
Withdrawal	9
Scheme	10
Ruling	18
Capital gains tax provisions	18
Application of subsection 44(1) of the ITAA 1936	24
Appendix 1 – Explanation	25
Capital gains tax provisions	25
Application of subsection 44(1) of the ITAA 1936	32
Appendix 2 – Detailed contents list	37

References

- Previous draft:*
- ITAA 1936 160ARDM
- Not previously issued as a draft
- ITAA 1997 104-25
 - ITAA 1997 104-25(2)
- Related Rulings/Determinations:*
- TR 92/20
- ITAA 1997 104-25(3)
 - ITAA 1997 110-25
 - ITAA 1997 110-25(1)
 - ITAA 1997 110-25(2)
- Subject references:*
- assessable income
 - CGT
 - cost base and reduced cost base
 - dividends
 - redemption
- ITAA 1997 110-55
 - ITAA 1997 110-55(1)
 - ITAA 1997 110-55(2)
 - ITAA 1997 116-20
 - ITAA 1997 116-20(1)
 - ITAA 1997 116-20(1)(a)
 - ITAA 1997 116-30
- Legislative references:*
- TAA 1953
 - ITAA 1936 6(1)
 - ITAA 1936 44(1)
 - Copyright Act 1968
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ATO references

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