



***CR 2006/9 - Preferred Capital Limited,
Commonwealth Bank of Australia - Perpetual
Exchangeable Repurchaseable Listed Securities
(PERLS III)***

 This cover sheet is provided for information only. It does not form part of *CR 2006/9 - Preferred Capital Limited, Commonwealth Bank of Australia - Perpetual Exchangeable Repurchaseable Listed Securities (PERLS III)*

 This document has changed over time. This is a consolidated version of the ruling which was published on *6 April 2006*



Class Ruling

Income tax: Preferred Capital Limited, Commonwealth Bank of Australia – Perpetual Exchangeable Repurchaseable Listed Securities (PERLS III)

Contents	Para
BINDING SECTION:	
What this Ruling is about	1
Date of effect	9
Withdrawal	10
Scheme	11
Assumptions	30
Ruling	31
NON BINDING SECTION:	
Appendix 1:	
Explanation	40
Appendix 2:	
Detailed contents list	67

❶ 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 '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 law(s) dealt with in this Ruling are:

- subsection 44(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 177EA of the ITAA 1936;
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 109-10 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997; and
- section 207-145 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the Australian resident individuals, companies and complying superannuation entities who subscribe for PERLS III (referred to as Holders in this Ruling).
4. The class of entities to which this Ruling applies does not include investors in the PERLS III who acquired them otherwise than by subscription.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement 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 11 to 30.
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 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*; or
 - the relevant tax laws are not amended.

Withdrawal

10. This Ruling is withdrawn and ceases to have effect after 30 June 2009. 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 arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Scheme

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

- application for a Class Ruling dated 9 January 2005 received from Greenwoods & Freehills on behalf of Preferred Capital Limited (PCL);
- draft Convertible Note Deed received 9 January 2006;
- draft Top-Up Deed received 9 January 2006;
- PERLS III terms of issue received 14 January 2006;
- Bank PERLS III Preference Share terms of issue received 9 January 2006;
- draft Exchange Deed received 9 January 2006;
- draft PERLS III – Perpetual Exchangeable Repurchaseable Listed Shares: Prospectus and Repurchase Information (Prospectus) received 17 January 2006 and to be issued on 23 February 2006;
- draft Constitution of Preferred Capital Limited dated 9 January 2006; and
- further information dated 17 January 2006.

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

13. PERLS III are preference shares in PCL, a special purpose company. The ordinary shares of PCL are held by the Commonwealth Bank of Australia (the Bank).

14. PCL will issue 2.5 million PERLS III to Australian resident retail and institutional investors at a face value of \$200 per share. There is a minimum application requirement of 25 PERLS III (or \$5,000).

15. Holders of the PERLS III are entitled to receive a non-cumulative floating rate dividend payable quarterly in arrears

(Dividend). Dividends paid on PERLS III are expected to be fully franked.

16. The Dividend payable for each period is calculated as follows:

$$\text{Dividend} = \frac{\text{Face Value} \times \text{Dividend Rate} \times \text{Days in Dividend Period}}{365}$$

17. The Dividend Rate is a floating rate and will be set on the first business day of each Dividend Period by applying a Margin per annum to the market rate per annum (which is the Bank Bill Swap Rate (BBSW) for 90 day bills on that date) and multiplying the sum by (1-Tax Rate). This is represented by the following formula:

$$\text{Dividend Rate} = (\text{Market Rate} + \text{Margin}) \times (1 - \text{Australian corporate tax rate})$$

18. If all or part of a Dividend is not paid, PCL will have no obligation to pay, and Holders will have no right to be paid, the unpaid Dividend.

19. If any Dividend is not paid in full within 20 business days of the Dividend Payment Date the Bank must not and PCL must procure that the Bank does not pay interest, declare or pay any dividends or distribution from the income or capital of the Bank, return any capital or undertake any buy-backs, redemptions or repurchases in relation to any securities of the Bank that rank equally for interest payments or distributions or junior to PERLS III unless and until:

- (i) such payment is approved by Special Resolution;
- (ii) PCL has paid Holders the full Dividend for the preceding 4 consecutive Dividend Periods; or
- (iii) PCL (with the approval of APRA) has paid to Holders an amount or amounts in aggregate equal to the unpaid amount or amounts of the Dividends for the preceding 4 consecutive Dividend Periods.

20. PCL may elect to exchange the PERLS III by giving notice to the Holders (PCL Exchange Notice) in the following circumstances:

- (i) on the Step-Up Date (6 April 2016);
- (ii) on any Dividend Payment Date after the Step-Up Date; or
- (iii) on the occurrence of a Regulatory or Tax Event.

21. If PERLS III are not exchanged on the Step-Up Date (6 April 2016) there will be a one time step-up of 1% in the Margin used to calculate the Dividend Rate (refer paragraph 17).

22. PCL may specify (at the Bank's election) to exchange the PERLS III in one or a combination of the following ways:

- (i) exchange some or all of the PERLS III for Bank ordinary shares; or
- (ii) exchange some or all of the PERLS III for cash equal to their face value, that is \$200 each (subject to APRA approval).

23. PERLS III will be automatically exchanged for Bank ordinary shares upon certain defined events affecting the capital of the Bank or upon certain defined events involving the Bank ceasing all of its business, or the commencement of proceedings for the dissolution, wind up or liquidation of the Bank or certain events involving a takeover bid of the Bank.

24. If PERLS III are exchanged for Bank ordinary shares, a PERLS III Holder is entitled to receive the number of Bank ordinary shares equal to the lesser of 100 Bank ordinary shares (the Maximum Conversion Number) or a number of Bank ordinary shares calculated in accordance with the PERLS III terms of issue.

25. PERLS III will be automatically exchanged for Bank PERLS III Preference Shares where:

- (i) a Dividend is not paid in full on PERLS III for any reason within 20 business days of the relevant Dividend Payment Date;
- (ii) at any time at the Bank's absolute discretion; or
- (iii) the day that is 10 business days before the Conversion Date of 6 April 2046.

26. Holders will receive one Bank PERLS III Preference Share for each PERLS III acquired by the Bank from the Holder.

27. All the proceeds from the issue of PERLS III will be used by PCL to purchase the mandatory convertible notes (MCNs) to be issued by the New Zealand Branch (NZ Branch) of the Bank.

28. The Bank has been given approval from APRA that the Scheme will qualify as Tier 1 regulatory capital of the Bank.

29. PCL will apply to have PERLS III listed on the Australian Stock Exchange.

Assumptions

30. This Ruling is made on the basis that:

- (i) During the term of the Scheme, the Bank, PCL and the Holders will be residents of Australia under the income tax laws of Australia and of no other jurisdiction;
- (ii) PCL will not debit any part of the Dividend payments on the PERLS III to a disqualifying account within the meaning of section 46H of the ITAA 1936;
- (iii) PCL will not have a surplus balance in its notional disqualifying account within the meaning of section 46I of the ITAA 1936 immediately before the time it makes distributions on the PERLS III;

- (iv) PCL will be a qualified person (within the meaning of subsection 995-1(1) of the ITAA 1997) in relation to any interest payments received on the MCNs;
- (v) 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; and
- (vi) Holders have not disposed of their PERLS III before 7 July 2006, being a period of at least ninety days (excluding the days of acquisition and disposal), beginning the day after 6 April 2006 pursuant to subsection 160APHO(2) of the ITAA 1936.

Ruling

Acquisition time of the PERLS III

31. For capital gains tax purposes, pursuant to section 109-10 of the ITAA 1997, each Holder is taken to acquire the PERLS III at the time their application is accepted.

Cost base and reduced cost base

32. For capital gains purposes, pursuant to sections 110-25 and 110-55 of the ITAA 1997, the first element of the cost base and reduced cost base of each PERLS III is \$200.

Dividends to be included in assessable income of Holders

33. Dividends on the PERLS III are included in the assessable income of the Holders pursuant to subsection 44(1) of the ITAA 1936.

Gross-up and tax offset

34. An amount equal to the franking credit on the Dividend (gross-up) is included in the assessable income of the Holders under subsection 207-20(1) of the ITAA 1997.

35. Holders will be entitled to a tax offset equal to the franking credit on the Dividend for the income year in which the distribution is made under section 207-20(2) of the ITAA 1997.

36. The tax offset will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997.

The anti-avoidance provisions***Section 207-145 of the ITAA 1997***

37. Section 207-145 of the ITAA 1997 will not apply to deny the gross-up and tax offset on the franked distribution on the PERLS III made to the Holders.

Section 204-30 of the ITAA 1997

38. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 that denies imputation benefits to a Holder in respect of a franked distribution paid on the PERLS III by PCL.

Section 177EA of the ITAA 1936

39. 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 PERLS III by PCL.

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.*

Acquisition time of the PERLS III

40. For capital gains tax purposes, Item 2 of the table 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. Accordingly, a Holder will be taken to have acquired the PERLS III at the time that the application is accepted.

Cost base and reduced cost base

41. For capital gains tax purposes, 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 it.

42. Accordingly, the first element of the cost base and reduced cost base of each PERLS III is \$200.

Dividends to be included in assessable income of Holders

43. Dividends on the PERLS III will be included in the assessable income of the Holders pursuant to subsection 44(1) of the ITAA 1936.

Gross-up and tax offset

44. An amount equal to the amount of the franking credit on the Dividend is included in the assessable income of each shareholder under subsection 207-20(1) of the ITAA 1997.

45. The Holders are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend.

46. The tax offset will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997 provided the Holders are not excluded by section 67-25 of the ITAA 1997.

The anti-avoidance provisions***Section 207-145 of the ITAA 1997***

47. Pursuant to Subdivision 207-F of the ITAA 1997 the gross-up and tax offset are denied in the circumstances set out in section 207-145 of the ITAA 1997. These circumstances include the following:

- the Holder is not a qualified person in relation to the Dividend for the purpose of Division 1A of the Part IIIA of the ITAA 1936;
- the Commissioner has made a determination under subsection 204-30 of the ITAA 1997 that no imputation benefit is to arise for the receiving entity in respect of the distribution; and
- 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.

48. However, based on the discussions below it has been concluded that section 207-145 of the ITAA 1997 will not apply and there will be no denial of the gross-up and tax offset available under section 207-20 of the ITAA 1997.

Qualified person

49. Section 995-1 of the ITAA 1997 provides that a person is a qualified person in relation to a distribution if they satisfy the holding period rule and related payments rule under Division 1A of Part IIIA of the ITAA 1936.

50. Provided that the Holders:

- hold the PERLS III at risk for a continuous period of at least 90 days (excluding the day of acquisition and disposal) pursuant to 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 a qualified persons as defined in section 995-1 of the ITAA 1997.

Section 204-30 of the ITAA 1997

51. Section 204-30 of the ITAA 1997 applies where an entity streams one or more distributions in such a way that the imputation benefits attaching to the distribution are received by members of the entity who derive a greater benefit from franking credits than other members and other members receive lesser imputation benefits, or no imputation benefits. Holders are members of the company pursuant to Item 1 of the table in subsection 960-130(1) of the ITAA 1997.

52. If section 204-30 of the ITAA 1997 applies, then the Commissioner may make a determination pursuant to paragraph 204-30(3)(c) of the ITAA 1997, inter alia, that no imputation benefit is to arise in respect of the distribution to those members who derive a greater benefit.

53. For section 204-30 of the ITAA 1997 to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than other members. The words 'derives a greater benefit from franking credits' (imputation benefits) are defined in subsection 204-30(8) of the ITAA 1997 by reference to the ability of the members to fully utilise imputation benefits.

54. Based on the information provided by PCL, all Holders of the PERLS III will receive franked Dividends proportional to their number of interests held, irrespective of their individual tax position. It cannot be said that there exists, in relation to the members of the company, a group of members that have a greater ability to use the franking credits than other members within the meaning of the words in subsection 204-30(8) of the ITAA 1997.

55. Accordingly, section 204-30 of the ITAA 1997 has no application.

Section 177EA of the ITAA 1936

56. 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.

57. 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.

58. The operative provision of section 177EA is subsection 177EA(3). This provision applies 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) of enabling the relevant taxpayer to obtain an imputation benefit.

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

60. The issue of PERLS III and the allotment of Bank ordinary shares or preference shares upon exchange of the PERLS III would constitute a scheme for a disposition of membership interests, and paragraph 177EA(3)(a) is satisfied.

61. The issue of PERLS III will result in the payment of a frankable distribution and the distribution is expected to be franked. Accordingly, subparagraph 177EA(3)(b)(i) and paragraph 177EA(3)(c) are satisfied.

62. Paragraph 177EA(3)(d) is met as PERLS III Holders would receive, or be reasonably expected to receive, imputation benefits as a result of the distribution.

63. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of PCL, the Holders or any other relevant party, there is a purpose 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).

64. The issue of the PERLS III is a capital raising transaction which PCL advises is undertaken to raise Tier 1 capital for the Bank. There is nothing in the terms of the issue which would suggest a tax avoidance purpose, and the arrangement does not result in PCL avoiding wastage of franking credits.

65. On the basis of the information provided it would not be reasonable to conclude that in entering into the scheme, the Holders or PCL demonstrate the objective purpose of securing imputation benefits for the Holders or PCL. 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.

66. Consequently, the Commissioner will not make a determination under paragraph 177EA(5)(b) that denies imputation benefits to a Holder in respect of a franked distribution paid on the PERLS III by PCL.

Appendix 2 – Detailed contents list

67. 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	5
Date of effect	9
Withdrawal	10
Scheme	11
Assumptions	30
Ruling	31
Acquisition time of the PERLS III	31
Cost base and reduced cost base	32
Dividends to be included in assessable income of the Holders	33
Gross-up and tax offset	34
The anti-avoidance provisions	37
<i>Section 207-145 of the ITAA 1997</i>	37
<i>Section 204-30 of the ITAA 1997</i>	38
<i>Section 177EA of the ITAA 1936</i>	39
Appendix 1 – Explanation	40
Acquisition time of the PERLS III	40
Cost base and reduced cost base	41
Dividends to be included in assessable income of the Holders	43
Gross-up and tax offset	44
The anti-avoidance provisions	47
<i>Section 207-145 of the ITAA 1997</i>	47
<i>Qualified person</i>	49
<i>Section 204-30 of the ITAA 1997</i>	51
<i>Section 177EA of the ITAA 1936</i>	56
Appendix 2 – Detailed contents list	67

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- CGT
- cost base and reduced cost base
- dividends streaming arrangements

Legislative references:

- TAA 1953
- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 44(1)
- ITAA 1936 46H
- ITAA 1936 46I
- ITAA 1936 160APHM
- ITAA 1936 160APHN
- ITAA 1936 160APHO
- ITAA 1936 160APHO(2)
- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1936 177EA(3)(a)

- ITAA 1936 177EA(3)(b)(i)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(14)(a)
- ITAA 1936 177EA(17)
- ITAA 1997 Div 67
- ITAA 1997 67-25
- ITAA 1997 109-10
- ITAA 1997 110-25
- ITAA 1997 110-25(2)(a)
- ITAA 1997 110-55
- ITAA 1997 110-55(2)
- ITAA 1997 204-30
- ITAA 1997 204-30(3)(c)
- ITAA 1997 204-30(8)
- ITAA 1997 Subdiv 207-F
- ITAA 1997 207-20
- ITAA 1997 207-20(1)
- ITAA 1997 207-20(2)
- ITAA 1997 207-145
- ITAA 1997 960-130(1)
- ITAA 1997 995-1
- ITAA 1997 995-1(1)
- Copyright Act 1968

ATO references

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