

CR 2014/86 - Income tax: Macquarie Bank Limited - Macquarie Bank Capital Notes

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Class Ruling

Income tax: Macquarie Bank Limited – Macquarie Bank Capital Notes

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

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

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

What this Ruling is about

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

Relevant provision(s)

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

- section 26BB of the *Income Tax Assessment Act 1936* (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 45C of the ITAA 1936
- section 70B of the ITAA 1936
- section 159GP of the ITAA 1936
- section 159GQ of the ITAA 1936
- Division 1A of former Part IIIA of the ITAA 1936

- section 177EA of the ITAA 1936
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-10 of the ITAA 1997
- section 104-25 of the ITAA 1997
- section 109-10 of the ITAA 1997
- subsection 110-25(2) of the ITAA 1997
- subsection 110-55(2) of the ITAA 1997
- section 130-60 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 207-20 of the ITAA 1997
- Subdivision 207-D of the ITAA 1997
- section 207-145 of the ITAA 1997
- subsection 974-75(1) 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 investors (referred to in this Ruling as Holders) who acquired fully paid, unsecured, subordinated, mandatorily convertible notes issued by Macquarie Bank Limited (MBL) called Macquarie Bank Capital Notes (BCN), and who:

- are residents of Australia (within the meaning of subsection 6(1) of the ITAA 1936) during the period in which they hold BCN
- do not hold their BCN as revenue assets (as defined in section 977-50 of the ITAA 1997) nor as trading stock (as defined in subsection 995-1(1) of the ITAA 1997) – that is, they hold their BCN on capital account, and
- are not subject to the taxation of financial arrangements (TOFA) rules in Division 230 of the ITAA 1997 in relation to gains and losses on their BCN.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them).

4. The class of entities to which this Ruling applies does not extend to the holders of BCN who did not acquire their BCN by initial application under the Prospectus for the issue of BCN dated 23 September 2014.

Qualifications

5. This Ruling does not consider the tax implications of the Exchange of the BCN on the occurrence of an Automatic Exchange Event, Acquisition Event, Regulatory Event or Tax Event.
6. This Ruling does not consider the tax implications of the Resale of the BCN under a Resale Notice.
7. This Ruling does not consider how the tax law applies to a Nominated Party who acquires their BCN under a Resale Notice.
8. This Ruling does not consider how the gross-up and tax offset rules in Division 207 of the ITAA 1997 apply to a Holder that is a partnership or the trustee of a trust, or to indirect distributions to partners in a partnership, or beneficiaries or trustees of a trust.
9. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.
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 49 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 July 2014 to 30 June 2023. The Ruling continues to apply after 30 June 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 following description of the scheme is based on information provided by Macquarie Group Limited (MGL). The following documents, or relevant parts of them, form part of and are to be read with this description:

- application for Class Ruling dated 25 September 2014

- BCN Prospectus lodged with the Australian Securities & Investments Commission (ASIC) dated 23 September 2014
- Terms and Conditions of the BCN attached as Appendix A to the Prospectus (BCN Terms)
- BCN Deed Poll dated 15 September 2014 (BCN Deed Poll)
- BCN Implementation Deed dated 15 September 2014
- Constitution of MGL as at 12 December 2013
- MGL's announcement to the Australian Securities Exchange (ASX) relating to its proposal to raise capital by the issue of the BCN dated 15 September 2014
- approval letter from the Australian Prudential Regulation Authority (APRA) to MBL dated 15 September 2014, and
- further correspondence from MGL.

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 Class Ruling, unless otherwise defined, capitalised terms take the meaning that they have in the BCN Terms.

15. MGL is an Australian resident company. The ordinary shares of MGL are listed on the ASX. MGL was established in November 2007 as the non-operating holding company (NOHC) of the MGL Group. The only shares that MGL has issued are ordinary shares (Ordinary Shares).

16. MGL is regulated by APRA as it is the parent company of Macquarie Bank Limited (MBL), an authorised deposit-taking institution (ADI) under the *Banking Act 1959* (Cth).

17. For Australian income tax purposes, MGL is the head company of the MGL income tax consolidated group. MBL is a subsidiary member of the MGL income tax consolidated group.

18. In the Prospectus, MBL announced its intention to undertake a capital raising by the issue of the BCN to raise \$420 million (the Offer) with the ability to raise more or less. MBL will use the net proceeds of the Offer for general corporate funding and capital management purposes.

19. On 15 September 2014, APRA confirmed that the proposed issue of the BCN will qualify for inclusion as Additional Tier 1 Capital of MBL, for the purposes of APRA's prudential standards governing MBL as an ADI.

20. There is no certainty that the BCN will be Exchanged, Redeemed or Resold as APRA approval for Redemption or Resale may not be granted, and in any event, MBL may be unwilling to Exchange, Redeem or Resell the BCN on a Scheduled Optional Exchange Date. Accordingly, the BCN may remain on issue after the Scheduled Optional Exchange Dates, and may still be on issue on the Mandatory Exchange Date (at which time they must be Exchanged, subject to satisfaction of the Exchange conditions).

21. The BCN were issued on 8 October 2014. The BCN were listed on the ASX and trade under the ASX code MBLPA.

22. The Prospectus states that persons wishing to acquire the BCN may apply under one or more of the following offers:

- Australian resident retail and high net worth clients of Syndicate Brokers and Institutional Investors (Broker Firm Offer)
- Eligible Securityholders (Securityholder Offer), or
- Members of the general public who are residents of Australia (General Offer).

Main features of the BCN

23. The obligations of MBL and MGL under the BCN are constituted by, and specified in, the BCN Deed Poll.

24. Each BCN is issued fully paid for an issue price of \$100 (Issue Price).

25. With the prior written consent of APRA, each BCN may be Redeemed or Resold by MBL, or Exchanged for fully paid MGL Ordinary Shares, in accordance with the BCN Terms.

26. Exchange is defined in clause 18.2 of the BCN Terms as the transfer of a BCN in exchange for MGL Ordinary Shares in accordance with and subject to clause 9 of the BCN Terms and the performance of the Related Exchange Steps.

27. The BCN cannot be Redeemed, Resold or Exchanged at the option of a Holder.

Distribution calculation

28. Subject to the BCN Terms, MBL shall pay a Distribution in respect of each BCN on each Distribution Payment Date to the registered Holder on the Record Date for that Distribution. The Distribution will be an amount of cash paid for the Distribution Period ending on that Distribution Payment Date calculated according to the following formula:

$$\text{Distribution} = \frac{\text{Distribution Rate} \times \text{A\$}100 \times \text{N}}{365}$$

where:

Distribution Payment Date means, in respect of a BCN:

- (a) each 24 March and 24 September commencing on 24 March 2015 until (but not including) the date on which that BCN has been Redeemed or Exchanged in accordance with the BCN Terms; and
- (b) the Redemption Date or, subject to clause 8.6(c), the Resale Date or an Exchange Date, except where the Exchange is on account of an Automatic Exchange Event;

Distribution Rate means:

(Reference Rate + Margin) × Franking Adjustment Factor,
where:

- (a) **Reference Rate** means, for a Distribution Period, the rate (expressed as a percentage per annum) which is the average mid-rate for Bills for a term of 180 days as displayed on the 'BBSW' page of the Reuters Monitor System (or any page that replaces that page) on the first Business Day of the Distribution Period. However, if the average mid-rate is not displayed by 10.30am on that day, or if it is displayed but MBL determines that there is a manifest error in that rate, Reference Rate means the rate specified by MBL in good faith at or around 10.30am on that day, having regard, to the extent possible, to:
 - (i) the rates otherwise bid and offered for Bills of a term of 180 days at or around that time on that day (including any displayed on the 'BBSW' page of the Reuters Monitor System (or any page that replaces that page)); and
 - (ii) if bid and offer rates for Bills of a term of 180 days are not otherwise available, the rates otherwise bid and offered for funds of a term of 180 days at or around that time on that day,

(and provided that where a BCN is Resold on a day which is not a scheduled semi-annual Distribution Payment Date, the Reference Rate for the Distribution Period commencing on the Resale Date is the Reference Rate for the Distribution Period preceding the Resale Date);

- (b) **Bills** has the meaning given in the Bills of Exchange Act 1909 (Cth);
- (c) **Franking Adjustment Factor** means:

$$\frac{(1 - T)}{1 - [T \times (1 - F)]}$$

where:

- (i) **F** means the Franking Rate; and

(ii) **T** means the Tax Rate;

(d) **Margin** means 3.30% per annum;

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

29. Distributions paid on the BCN are expected to be franked at the same percentage that applies to MGL's Ordinary Shares. The franking percentage of Distributions may vary over time in line with the franking percentage that applies to MGL Ordinary Shares.

Distribution payment conditions

30. The payment of any Distribution will be made unless:

- (a) MBL, in its absolute discretion, determines that the Distribution is not payable to Holders;
- (b) payment of the Distribution would result in MBL breaching APRA's capital adequacy requirements applicable to it;
- (c) payment of the Distribution would result in MBL becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*; or
- (d) APRA objects to the payment of the Distribution.

31. In determining not to pay a Distribution, MBL shall consider payment of Distributions as if it were payment of a dividend on a preference share which is an Equal Ranking Obligation.

32. Distributions are non-cumulative, and interest is not payable by MBL on any unpaid Distributions. MBL has no liability to pay the unpaid amount of the Distribution and Holders have no claim or entitlement in respect of such non-payment.

33. A Dividend Restriction applies to MBL if MBL fails to pay a Distribution in full within 10 business days of the relevant Distribution Payment Date. A Dividend Restriction means that MBL must not, without prior approval of a Special Resolution of the Holders:

- (i) determine, declare or pay any MBL Ordinary Share Dividend; or
- (ii) undertake any Buy-Back or Capital Reduction.

Scheduled Mandatory Exchange

34. MBL must Exchange all of the BCN for MGL Ordinary Shares on the date that is the earlier of (each a Mandatory Exchange Date):

- 24 March 2023 (Scheduled Mandatory Exchange Date), or
- any Distribution Payment Date after the Scheduled Mandatory Exchange Date,

on which the Exchange Conditions are satisfied, unless the BCN have been or will be Redeemed or Exchanged before that date.

35. Broadly, the Exchange Conditions are:

- the Daily Volume Weighted Average Price (VWAP) of MGL Ordinary Shares on the 25th Business Day prior to the Relevant Mandatory Exchange Date is greater than 56% of the Issue Date VWAP (First Exchange Condition)
- the VWAP during the 20 ASX Trading Days prior to the Relevant Mandatory Exchange Date is such that the number of MGL Ordinary Shares to be issued is less than or equal to the Maximum Exchange Number applicable to a Mandatory Exchange Date (Second Exchange Condition)
- no Suspension Event applies in respect of the Relevant Mandatory Exchange Date (Third Exchange Condition), and
- MGL is not Delisted as at the Relevant Mandatory Exchange Date (Fourth Exchange Condition),

Optional Exchange

36. MBL may, in its sole discretion, elect to Exchange all or some of the BCN:

- on any Scheduled Optional Exchange Date, and
- following the occurrence of a Tax Event or Regulatory Event.

37. The Scheduled Optional Exchange Dates are the Distribution Payment Dates falling on or about:

- (a) 24 March 2020 (the First Scheduled Optional Exchange Date)
- (b) 24 September 2020 (the Second Scheduled Optional Exchange Date), and
- (c) 24 March 2021 (the Third Scheduled Optional Exchange Date).

38. The Second, Third and Fourth Exchange Conditions (as described in paragraph 35) also apply to an Optional Exchange. There are two additional restrictions on an Optional Exchange under clause 5.4 of the BCN Terms.

Acquisition Event and Automatic Exchange Event

39. If an Acquisition Event occurs, MBL must Exchange all of the BCN subject to the conditions in clause 6.1 of the BCN Terms. If an Automatic Exchange Event occurs, MBL must Exchange (in accordance with clause 4 of the BCN Terms) such number of the BCN as complies with an APRA notice.

General provisions applicable to Exchange

40. Broadly, on Exchange:

- Each BCN will be automatically transferred free from any Encumbrance to MGL, or only with APRA's written approval obtained prior to the Exchange Date, to another subsidiary of MGL which is a holding company of MBL on the Exchange Date nominated by MGL.
- MGL will allot and issue the Exchange Number of MGL Ordinary Shares to the Holders (or as they may direct) for each BCN held by the Holder.
- If the total number of MGL Ordinary Shares to be allotted to a Holder in respect of their aggregate holding of BCN upon Exchange includes a fraction of an MGL Ordinary Share, that fraction of an MGL Ordinary Share will be disregarded.

41. The Exchange Number is calculated in accordance with the formula set out in clause 9.1 of the BCN Terms, subject to the Exchange Number being no greater than the Maximum Exchange Number.

Optional Redemption

42. MBL may, in its sole discretion, but with APRA's prior written approval, elect to Redeem all or some of the BCN on a Scheduled Optional Exchange Date, or Redeem all or some of the BCN following the occurrence of a Tax Event or a Regulatory Event, by way of notice to the Holders.

43. On the Redemption Date, the BCN being Redeemed will be Redeemed by payment of the Issue Price of that BCN to the Holder recorded on the Register at the Redemption Date, and Distributions from (and including) the immediately preceding Distribution Payment Date and up to (but excluding) the Redemption Date will be paid in respect of the BCN being Redeemed on such date, subject to the conditions on the payment of Distributions as described in paragraph 30 of this Ruling being met.

44. Upon payment of the Redemption Price and any Distribution payable on the Redemption Date, all other rights conferred, or restrictions imposed, by each BCN being Redeemed on that date will no longer have effect and that BCN will be cancelled.

Resale

45. On any date on which it may issue a Redemption Notice, in lieu of such Redemption Notice, MBL may, in its sole discretion, but with APRA's prior written approval, issue to each Holder a notice (a Resale Notice) specifying that all or some of each Holder's holding of the BCN will be transferred to one or more Nominated Parties (Resale).

46. If MBL gives a Resale Notice, each Holder on the Resale Date is taken to irrevocably offer to sell the BCN that are the subject of the Resale Notice to the Nominated Party or Nominated Parties on the Resale Date for a purchase price per BCN equal to the Issue Price of that BCN (the Resale Price).

Sale Agent

47. Under clause 9.2 of the BCN Terms, each Holder agrees to provide to MBL, MGL (and, where clause 9.13 of the BCN Terms applies, the Sale Agent) any information necessary or desirable to give effect to an Exchange.

48. If any BCN of a Holder are required to be Exchanged and if, amongst other criteria in clause 9.13 of the BCN Terms, the Holder has notified MBL that it does not wish to receive MGL Ordinary Shares as a result of the Exchange (whether partly or entirely), then MBL will use reasonable endeavours to appoint a Sale Agent (which is not MBL or any Related Entity of MBL) to sell the MGL Ordinary Shares, and pay to the relevant Holder a cash amount equal to the Attributable Proceeds of the relevant Holder.

Other matters

49. The Ruling is made on the basis that:

- (a) The documents listed in paragraph 13 of this Ruling provide a complete and accurate description of the scheme, are intended by the parties to have their legal effect, and will be implemented according to their terms.
- (b) During the term of the scheme, MBL will be a resident of Australia under the income tax law of Australia and of no other jurisdiction.
- (c) Each BCN is an 'equity interest' in MBL under Division 974 of the ITAA 1997 and a 'non-share equity interest' in MBL as defined in subsection 995-1(1) of the ITAA 1997.
- (d) The MGL Ordinary Shares obtained by a Holder on the Exchange of the BCN will be an 'equity interest' in MGL under Division 974 of the ITAA 1997.

- (e) Each Distribution paid in respect of the BCN will be a 'frankable distribution' under section 202-40 of the ITAA 1997 and will not be 'unfrankable' under section 202-45 of the ITAA 1997.
- (f) MGL (as the head company of the income tax consolidated group of which MBL is a subsidiary member) is expected to frank each Distribution in respect of the BCN (being a 'frankable distribution') in accordance with its franking policy that applies to MGL Ordinary Shares (at such a time as Distributions are made), and in a manner that satisfies the benchmark rule in Division 203 of the ITAA 1997 for the franking period in which a frankable distribution is made.
- (g) MGL will not differentially frank Distributions to different Holders in respect of the BCN according to the tax status of Holders or on any other basis.
- (h) Distributions in respect of the BCN will not be debited to MBL'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).
- (i) Distributions in respect of the BCN will be sourced from the accounting income of MBL.
- (j) Immediately before payment of a Distribution on the BCN, MBL will have sufficient available frankable profits (worked out under section 215-20 of the ITAA 1997) to pay the Distribution.
- (k) The share capital account of MBL will not become tainted (within the meaning of Division 197 of the ITAA 1997) by the issue of the BCN or the issue of MGL Ordinary Shares on Exchange.
- (l) The policy of MGL (as the head company of the income tax consolidated group of which MBL is a subsidiary member) in relation to the franking of dividends on the MGL Ordinary Shares is not expected to change as a result of the issuance of the BCN.
- (m) On Exchange or Redemption of the BCN, MBL will debit the Issue Price of the BCN to its non-share capital account (within the meaning of section 164-10 of the ITAA 1997).
- (n) For the purposes of determining whether a Holder is a 'qualified person' in relation to the Distributions under Division 1A of former Part IIIAA of the ITAA 1936, neither nor an associate of a Holder will take any 'position' (within the meaning of former section 160APHJ of the ITAA 1936) in relation to their BCN, apart from holding the BCN.

- (o) A Holder, or an associate of a Holder, will not make, is not under an obligation to make, or is not likely to make, a related payment (within the meaning of former section 160APHN of the ITAA 1936) in respect of any of the Distributions.
- (p) The Holders in receipt of Distributions on the BCN will hold their BCN for a period of at least 90 days (excluding the day of acquisition and disposal) beginning on the day after the acquisition of the BCN.
- (q) The accounts of the MGL group are, and will continue to be, prepared in accordance with applicable accounting standards.

Ruling

Acquisition time of the BCN

50. Under item 2 of the table in section 109-10 of the ITAA 1997, a Holder acquired their BCN on 23 September 2014, being the date on which the contract for the allotment of the BCN was entered into.

Cost base and reduced cost base of the BCN

51. Under subsections 110-25(2) and 110-55(2) of the ITAA 1997, the first element of the cost base and reduced cost base of each BCN was \$100.

Inclusion of Distributions and franking credits in assessable income

52. The Holders must include in their assessable income all Distributions received in respect of their BCN under subparagraph 44(1)(a)(ii) of the ITAA 1936, and the amount of the franking credit on those Distributions under subsection 207-20(1) of the ITAA 1997, unless Subdivision 207-D of the ITAA 1997 applies.

Entitlement to a franking credit tax offset

53. The Holders are entitled to a tax offset equal to the franking credit on the Distributions under subsection 207-20(2) of the ITAA 1997, unless Subdivision 207-D of the ITAA 1997 applies.

54. The Holders who are entitled to a franking credit tax offset under Division 207 of the ITAA 1997 will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997. Certain trustees and corporate tax entities are excluded from the refundable tax offset rules under section 67-25 of the ITAA 1997.

Imputation benefits – streaming

55. 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 the Holders in respect of the Distributions paid on the BCN.

Section 177EA of the ITAA 1936

56. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by the Holders in respect of the Distributions paid on the BCN.

Gross-up and tax offset

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

58. For the purpose of determining whether a Holder is a 'qualified person' in relation to the Distributions under Division 1A of former Part IIIA of the ITAA 1936 (which is relevant to paragraph 207-145(1)(a) of the ITAA 1997), the Resale mechanism (of itself) and the Exchange mechanism (of itself) will not affect a Holder's risks of loss or opportunities for gain in respect of the BCN. This is because neither the Resale mechanism nor the Exchange mechanism constitutes a separate position (former sections 160APHJ and 160APHM of the ITAA 1936).

The BCN are not a traditional security

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

60. A gain on the disposal or redemption of the BCN will not give rise to assessable income under subsection 26BB(2) of the ITAA 1936. A loss on the disposal or redemption of the BCN will not give rise to an allowable deduction under subsection 70B(2) of the ITAA 1936.

The BCN are not a qualifying security

61. The BCN are not a 'qualifying security' as defined in subsection 159GP(1) of the ITAA 1936. Therefore, Division 16E of Part III of the ITAA 1936 will not apply to the BCN. Specifically, section 159GQ of the ITAA 1936 will not include Distributions in the assessable income of the Holders on an accruals basis.

Exchange of the BCN – CGT implications

62. CGT event C2 (section 104-25 of the ITAA 1997) will happen for the Holders on the Exchange of the BCN for MGL Ordinary Shares. The BCN are a 'convertible interest' in MBL (as defined in subsection 995-1(1) of the ITAA 1997 and item 4 of the table in subsection 974-75(1) of the ITAA 1997), and the Exchange will be the conversion of a convertible interest.

63. Subdivision 130-C of the ITAA 1997 governs the CGT consequences of the conversion of a convertible interest. Any capital gain or capital loss made by the Holders from CGT event C2 happening on the Exchange of the BCN will be disregarded (subsection 130-60(3) of the ITAA 1997).

Cost base and reduced cost base of MGL Ordinary Shares acquired on Exchange

64. On the Exchange of the BCN, the first element of the cost base and the reduced cost base of the MGL Ordinary Shares acquired under the Exchange of the BCN will be the cost base of the BCN at the time of conversion, which will be the relevant Exchange Date (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of MGL Ordinary Shares on Exchange

65. The MGL Ordinary Shares acquired by the Holders under the Exchange of the BCN will be taken to have been acquired when the Exchange happens on the relevant Exchange Date (subsection 130-60(2) of the ITAA 1997).

Acquisition of MGL Ordinary Shares on Exchange not included in assessable income

66. The value of the MGL ordinary shares will not be included in the assessable income of the Holders under subsection 44(1) of the ITAA 1936.

Section 45 of the ITAA 1936

67. Section 45 of the ITAA 1936 will not apply to treat the value of the MGL Ordinary Shares issued to the Holders on the Exchange of the BCN as an unfrankable dividend paid by MGL to the Holders.

Section 45A of the ITAA 1936

68. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or any part, of the capital benefit provided to the Holders on the Exchange or the Redemption of the BCN as an unfranked dividend paid by MGL to the Holders.

Section 45B of the ITAA 1936

69. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or any part, of the capital benefit provided to the Holders on the Exchange or the Redemption of the BCN as an unfranked dividend paid by MGL to the Holders.

CGT event A1 happens on the disposal of MGL Ordinary Shares by a Sale Agent on behalf of a Holder

70. CGT event A1 will happen to a Holder where, following the Exchange of the BCN, a Holder elects for a Sale Agent to dispose (on behalf of the Holder) of their allocation of MGL Ordinary Shares and remit the net sale proceeds to the Holder (section 104-10 of the ITAA 1997).

71. The time of CGT event A1 will be when the Sale Agent, on behalf of the Holder, enters into the contract for the sale of the MGL Ordinary Shares (paragraph 104-10(3)(a) of the ITAA 1997).

72. The first element of the cost base and the reduced cost base of the MGL Ordinary Shares acquired by a Holder under the Exchange of the BCN, and sold on behalf of the Holder by the Sale Agent, will be determined by item 2 of the table in subsection 130-60(1) of the ITAA 1997 (see paragraph 63).

73. The MGL Ordinary Shares acquired by a Holder under the Exchange of the BCN, and sold on behalf of the Holder by the Sale Agent, will be taken to have been acquired on the date determined by subsection 130-60(2) of the ITAA 1997 (see paragraph 64).

Commissioner of Taxation15 October 2014]

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 BCN

74. Where a company issues or allots equity interests in the company, the equity interests are 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).

75. The BCN are equity interests in MBL. When an investor's application for a certain number of the BCN is accepted by MBL, this leads to the formation of a contract for the allotment of the BCN to the investor (who will become a Holder). Under item 2 of the table in section 109-10 of the ITAA 1997, a Holder will acquire their BCN on 23 September 2014, being the date on which the contract for the allotment of the BCN was entered into.

Cost base and reduced cost base of the BCN

76. The first element of the cost base and the 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) and subsection 110-55(2) of the ITAA 1997).

77. The Issue Price of each BCN was \$100. Accordingly, when the BCN were issued, the first element of a Holder's cost base and reduced cost base of each BCN was \$100.

Inclusion of Distributions and franking credits in assessable income

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

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

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

80. The Distributions paid in respect of the BCN will be a 'non-share dividend' as defined in section 974-120 of the ITAA 1997. Accordingly, the Holders must include the Distributions paid in respect of the BCN in their assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

81. MBL expects that the Distributions paid in respect of the BCN will be franked.

82. Under the Australian imputation system, where an Australian resident company makes a franked distribution to another entity, subsection 207-20(1) of the ITAA 1997 requires that the assessable income of the receiving entity must include the amount of the franking credit on the distribution. The inclusion of both the distribution and the attached franking credit in a receiving entity's assessable income is known as 'grossing-up' the distribution.

83. Accordingly, the Holders must include in their assessable income the amount of the franking credit on the Distributions that are received by the Holders.

Entitlement to a franking credit tax offset

84. Under subsection 207-20(2) of the ITAA 1997, the Holders are entitled to a tax offset equal to the franking credit on the Distributions.

85. The Holders who are entitled to a franking credit tax offset under subsection 207-20(2) of the ITAA 1997 will 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. The refundable tax offset rules ensure that certain taxpayers are entitled to a refund, once their available tax offsets have been utilised to reduce any income tax liability to nil.

86. Accordingly, the Holders will be subject to the refundable tax offset rules unless they are a type of entity that is specifically excluded under section 67-25 of the ITAA 1997.

87. Entities excluded by 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 in subsections 67-25(1C) or 67-25(1D) of the ITAA 1997.

Imputation benefits – streaming

88. 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.

89. 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 a corporate tax entity 'streams' the payment of distributions, or the payment of distributions and the giving of other benefits, to its members in such a way that:

- an 'imputation benefit' is, or apart from section 204-30 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 disadvantaged member receives other benefits (paragraph 204-30(1)(c) of the ITAA 1997).

90. Relevantly, if section 204-30 of the ITAA 1997 applies, the Commissioner has a discretion under subsection 204-30(3) of the ITAA 1997 to make a written determination either:

- (a) that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a) of the ITAA 1997); or
- (b) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination (paragraph 204-30(3)(c) of the ITAA 1997).

91. The term 'streaming' 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).

92. For section 204-30 of the ITAA 1997 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The words 'derive a greater benefit from franking credits' are defined in subsection 204-30(8) of the ITAA 1997 by reference to the ability of the members to fully utilise imputation benefits. The imputation benefit for resident members is in the form of a tax offset (paragraph 204-30(6)(a) of the ITAA 1997), and for non-resident members is in the form of not being liable to pay dividend withholding tax (paragraph 204-30(6)(e) of the ITAA 1997). The resident members derive a greater benefit from franking credits than the non-resident members.

93. The BCN will be listed on the ASX and hence will be available for investment by different types of investors. MGL (as the head company of the income tax consolidated group of which MBL is a subsidiary member) has indicated that all Holders will receive franked Distributions regardless of their tax attributes or their individual tax position. MGL's policy in relation to the franking of its frankable distributions is not expected to change as a result of the issue of the BCN.

94. The MGL Ordinary Shares allotted on the Exchange of the BCN will not attract the application of section 204-30 of the ITAA 1997. This is because the issue of MGL Ordinary Shares will not constitute a 'distribution' (as defined in section 960-120 of the ITAA 1997), and the allotment of MGL Ordinary Shares will not affect MGL's dividend franking policy.

95. 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 MGL to the 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 that are to be received by the Holders in respect of the Distributions paid on the BCN.

Section 177EA of the ITAA 1936

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

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

- debit the company's franking account pursuant to paragraph 177EA(5)(a) of the ITAA 1936; or

- deny the imputation benefit on the distribution that flowed directly or indirectly to each shareholder pursuant to paragraph 177EA(5)(b) of the ITAA 1936.

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

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

99. 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.

100. Under this arrangement, the 'relevant taxpayer' is a Holder of the BCN, and the scheme comprises the circumstances surrounding the issue of the BCN to the Holders who acquired their BCN by initial application under the Prospectus.

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

- (a) the issue of the BCN (being a non-share equity interest) pursuant to the Prospectus is a scheme for the disposition of (deemed) membership interests in a corporate tax entity (paragraph 177EA(3)(a) of the ITAA 1936). Paragraph 177EA(14)(a) of the ITAA 1936 provides that a 'scheme for a disposition of membership interests or an interest in membership interests' includes a scheme that involves issuing the membership interests.
- (b) the Distributions on the BCN are each a frankable distribution that is expected to be payable to the Holders in respect of their BCN (paragraph 177EA(3)(b) of the ITAA 1936). This is on the basis that the Distributions on the BCN do not satisfy any of the criteria to be unfrankable in section 202-45 of the ITAA 1997.
- (c) the Distributions on the BCN are each expected to be a franked distribution (paragraph 177EA(3)(c) of the ITAA 1936).
- (d) the Holders could reasonably be expected to receive imputation benefits as a result of Distributions on the BCN, given that MGL expects to frank the Distributions on the BCN (paragraph 177EA(3)(d) of ITAA 1936).

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

103. In arriving at a conclusion, the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of circumstances which, taken individually or collectively, could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may not be present at any one time in any one scheme.

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

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

Gross-up and tax offset

106. 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. Section 207-145 of the ITAA 1997 is relevant to the Holders that are the subject of this Ruling.

107. Pursuant to subsection 207-145(1) of the ITAA 1997, this adjustment will occur where a franked distribution is made to an entity in one or more of the following circumstances:

- The entity is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of former Part IIIAA of the ITAA 1936 (paragraph 207-145(1)(a) 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).
- The distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d) of the ITAA 1997).

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

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

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

(b) where the taxpayer or an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

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

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

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

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

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

114. Under former subsection 160APHM(2) of the ITAA 1936, a taxpayer is taken to have materially diminished risks of loss or opportunities for gain in respect of shares if the taxpayer's 'net position' (defined in former subsection 160APHJ(5) of the ITAA 1936) on a particular day in relation to the shares has less than 30% of those risks and opportunities. Every 'position' (defined in former subsection 160APHJ(2) of the ITAA 1936) in relation to the shares is taken into account in calculating the 'net position' in relation to the shares.

115. In accordance with former subsection 160APHJ(2) of the ITAA 1936, a 'position' in relation to a share is anything that has a 'delta' in relation to that share. Although 'delta' is not a defined term, paragraph 4.56 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1999 states that:

Delta is a well-recognised financial concept that measures the relative change in the price of an option or other derivative for a given small change in the price of an underlying asset. An option with a positive delta indicates that its price is expected to rise and fall with the underlying asset, while a negative delta indicates an inverse relationship.

116. The requirement to exclude any days on which the shareholder has materially diminished risks of loss or opportunities for gain in respect of shares is often referred to in positive terms as requiring the shareholder to only count the days during the relevant qualification period on which they hold the shares 'at risk'.

117. This Ruling is made on the basis that a Holder or an associate of a Holder has not made, is not under an obligation to make, or is not likely to make, a related payment in respect of any of the Dividends (see subparagraph 49(o) of this Ruling).

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

119. The former section 160APHD of the ITAA 1936 defines the 'primary qualification period' in relation to a taxpayer in relation to shares as:

... (b) if the shares are preference shares – the period beginning on the day after the day on which the taxpayer acquired the shares, and ending on the 90th day after the day on which the shares became *ex dividend*.

120. The former subsection 160APHE(1) of the ITAA 1936 defines '*ex dividend*' as:

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

121. Each of the Holders will be capable of being a 'qualified person' under the former paragraph 160APHO(1)(a) of the ITAA 1936, because this Ruling is made on the basis that (see subparagraphs 49(n) and (p) of this Ruling):

- neither a Holder nor an associate of a Holder has taken any position (apart from holding the BCN) in relation to their BCN; and

- the Holders in receipt of Distributions on the BCN will hold their BCN for a period of at least 90 days (excluding the day of acquisition and disposal) beginning on the day after the acquisition of the BCN.

122. An embedded share option is a 'position' in relation to a share if it is exercisable by or against a party other than the issuer of the share (Taxation Determination TD 2007/29).

123. Under the Resale provisions in clause 8 of the BCN Terms, MBL may (subject to certain conditions) require the Holders to sell all or some of their BCN to one or more Nominated Parties. Until MBL appoints an entity as a Nominated Party, that entity has no right or ability to call for the BCN from the Holders. No BCN can, or will, be Resold at the option of a Holder.

124. MBL is not required to exercise the Resale mechanism. It follows that the Resale mechanism is an option that is held by MBL, the issuer of the BCN, and not by a third party. Therefore, for the purpose of determining whether a Holder is a 'qualified person' in relation to the Distributions under Division 1A of former Part IIIAA of the ITAA 1936 (which is relevant to paragraph 207-145(1)(a) of the ITAA 1997), the Resale mechanism does not constitute a separate 'position' in relation to the BCN under former subsection 160APHJ(2) of the ITAA 1936 because, of itself, it will not affect a Holder's risks of loss or opportunities for gain in respect of the BCN.

125. In some scenarios, MBL must Exchange the BCN for MGL Ordinary Shares. In an Optional Exchange, MBL may Exchange the BCN for MGL Ordinary Shares. However, the BCN cannot be Exchanged at the option of a Holder.

126. Therefore, for the purpose of determining whether a Holder is a 'qualified person' in relation to the Distributions under Division 1A of former Part IIIAA of the ITAA 1936 (which is relevant to paragraph 207-145(1)(a) of the ITAA 1997), the Exchange mechanism does not constitute a separate 'position' in relation to the BCN under former subsection 160APHJ(2) of the ITAA 1936 because, of itself, it will not affect a Holder's risks of loss or opportunities for gain in respect of the BCN.

127. If a Holder of the BCN is not a 'qualified person' under the former paragraph 160APHO(1)(a) of the ITAA 1936, or other provisions such as former sections 160APHR or 160APHT of the ITAA 1936, the Holder will not be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936. Section 207-145 of the ITAA 1997 will create the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for the Holder in relation to payments of some or all of the Distributions.

128. For the purpose of determining whether a Holder is a 'qualified person' in relation to the Distributions under Division 1A of former Part IIIA of the ITAA 1936, the Commissioner has concluded that the Resale mechanism and the Exchange mechanism in relation to the BCN will not, of themselves, affect a Holder's risks of loss or opportunities for gain in respect of the BCN.

129. The Commissioner has confirmed that no determination will be made under paragraph 204-30(3)(c) of the ITAA 1997 or paragraph 177EA(5)(b) of the ITAA 1936 to deny the imputation benefits attached to Distributions paid by MBL to the Holders (see paragraphs 95 and 105 of this Ruling).

130. Finally, section 207-145 of the ITAA 1997 applies where a distribution is made as part of a dividend stripping operation. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to section 207-155 of the ITAA 1997, if the making of the distribution arose out of, or was made in the course of, a scheme that:

- was by way of, or in the nature of, dividend stripping; or
- had substantially the effect of a scheme by way of, or in the nature of, dividend stripping.

131. The BCN Terms and Prospectus provide no indication that the offering of the BCN and the associated payment of franked Distributions to the Holders constitute a dividend stripping arrangement.

132. Therefore, section 207-145 of the ITAA 1997 will not apply to the Distributions received by the Holders in respect of the BCN. Accordingly, section 207-145 of the ITAA 1997 will not adjust the Holders' assessable income to exclude the amount of the franking credit on the Distributions, nor will it deny the tax offset to which the Holders would otherwise be entitled

The BCN are not a traditional security

133. 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 certain conditions.

134. The term 'security' is defined in subsection 26BB(1) of the ITAA 1936 by reference to its meaning in Division 16E of Part III of the ITAA 1936. Pursuant to subsection 159GP(1) of the ITAA 1936, '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.

135. The BCN are not stock, a bond, debenture, certificate of entitlement, bill of exchange, or promissory note.

136. 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).

137. Paragraphs (b) and (c) of the definition of 'security' do not apply in this case, because the BCN are neither a deposit with a bank or other financial institution, nor a secured or unsecured loan.

138. Paragraph (d) of the definition of 'security' applies to those contracts that have debt like obligations (Taxation Ruling TR 96/14)

139. The BCN Terms do not evidence a liability by MBL to pay an amount or amounts to the Holders of the BCN during the term of the instrument or at maturity.

140. The BCN are perpetual and the Holders do not have a right to require Exchange, Resale or Redemption.

141. The payment by MBL of Distributions is subject to the Distribution payment conditions in clause 2.3 of the BCN Terms. The Distributions are discretionary and non-cumulative. If a Distribution is not paid, MBL has no liability to pay the Distribution and Holders have no claim in respect of non-payment.

142. Furthermore, the BCN Terms provide for the Exchange of the BCN in return for MGL allotting and issuing the Exchange Number of MGL Ordinary Shares based on the issue Price of the BCN and a formula set out in the BCN Terms for each BCN held by the Holders. The Redemption of the BCN is possible at the option of MBL and requires the prior written approval of APRA. This does not establish a liability on MBL to pay an amount.

143. MBL will not become liable to pay an amount in respect of the BCN upon winding up as it would be expected that, before winding up commences, the BCN would either be Exchanged into MGL Ordinary Shares pursuant to an Automatic Exchange Event (in which case any payment would be made to the Holders as ordinary shareholders as opposed to under the BCN Terms), or the Holders' rights would be terminated where MGL is not able to allot and issue Ordinary Shares within the time stated in the BCN Terms (clause 9.16 of the BCN Terms).

144. No part of the BCN Terms establishes a liability on MBL to pay an amount that exhibits the debt like obligation contemplated by paragraph (d) of the definition of 'security'.

145. As the BCN are not a 'security' within the meaning of subsection 159GP(1) of the ITAA 1936, they cannot be a 'traditional security' under subsection 26BB(1) of the ITAA 1936.

146. Accordingly, a gain on the disposal or redemption of the BCN will not give rise to assessable income under subsection 26BB(2) of the ITAA 1936. A loss on the disposal or redemption of the BCN will not give rise to an allowable deduction under subsection 70B(2) of the ITAA 1936.

The BCN are not a qualifying security

147. Under Division 16E of Part III of the ITAA 1936, the income and deductions from a 'qualifying security' are spread over the term of the security on an accruals basis which reflects the economic gains and losses which have accrued at any point in time (section 159GQ of the ITAA 1936).

148. A 'qualifying security' is defined in subsection 159GP(1) of the ITAA 1936 and must, among other requirements, be a 'security'. The BCN are not a 'security' within the meaning of subsection 159GP(1) (see paragraph 145). Therefore, the BCN are not a 'qualifying security' for the purposes of Division 16E of Part III of the ITAA 1936.

Exchange of the BCN – CGT implications

149. CGT event C2 (section 104-25 of the ITAA 1997) will happen for the Holders on the Exchange of the BCN for MGL Ordinary Shares.

150. 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' (as defined in subsection 995-1(1) of the ITAA 1997) being converted.

Convertible interest

151. A 'convertible interest' in a company is defined in subsection 995-1(1) of the ITAA 1997 as an interest of the kind referred to in item 4 of the table in subsection 974-75(1) of the ITAA 1997.

152. Paragraph (b) of item 4 of the table in subsection 974-75(1) of the ITAA 1997 refers to an interest issued by the company that is an 'interest that will, or may, convert into an equity interest in the company or a connected entity of the company.'

153. Section 974-165 of the ITAA 1997 states that an interest (the first interest) is an interest that will or may convert into another interest (the second interest) if one of various scenarios happens. One such scenario is that the first interest must be or may be satisfied by the issue of the second interest (whether to the holder of the first interest or to some other person) (subparagraph 974-165(b)(i) of the ITAA 1997).

154. The BCN will be an interest issued by MBL. MGL is a connected entity (as defined in subsection 995-1(1) of the ITAA 1997) of MBL. The MGL Ordinary Shares are an equity interest in MGL. The BCN must be or may be satisfied by the issue of the MGL Ordinary Shares by MGL to the Holders (or as they may direct). The mechanics of an Exchange in clause 9 of the BCN Terms satisfy item 4 of the table in subsection 974-75(1) and subparagraph 974-165(b)(i) of the ITAA 1997.

155. Accordingly, the BCN are a 'convertible interest' in MBL (as defined in subsection 995-1(1) of the ITAA 1997 and item 4 of the table in subsection 974-75(1) of the ITAA 1997).

156. The Exchange of the BCN for MGL Ordinary Shares will be the conversion of a convertible interest.

157. Subdivision 130-C of the ITAA 1997 governs the CGT consequences of the conversion of a convertible interest, such as the Exchange of the BCN. Under subsection 130-60(3) of the ITAA 1997, any capital gain or capital loss made from converting a convertible interest is disregarded. Any capital gain or capital loss made by the Holders from CGT event C2 happening on the Exchange of the BCN will be disregarded.

Cost base and reduced cost base of MGL Ordinary Shares acquired on Exchange

158. On the Exchange of the BCN, Subdivision 130-C of the ITAA 1997 will apply so that the first element of the cost base and the reduced cost base of the MGL Ordinary Shares acquired under the Exchange of the BCN will be the cost base of the BCN at the time of conversion, which will be the relevant Exchange Date (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of MGL Ordinary Shares on Exchange

159. The MGL Ordinary Shares acquired by the Holders under the Exchange of the BCN will be taken to have been acquired when the Exchange happens on the relevant Exchange Date (subsection 130-60(2) of the ITAA 1997).

Acquisition of MGL Ordinary Shares on Exchange not included in assessable income

160. The issue of MGL Ordinary Shares to the Holders of the BCN on the Exchange is a distribution of property to holders of a non-share equity interest. This means that it is a 'non-share distribution' under section 974-115 of the ITAA 1997. Subsection 974-120(1) of the ITAA 1997 states that, subject to subsection 974-120(2) of the ITAA 1997, all non-share distributions are a non-share dividend.

161. Subsection 974-120(2) of the ITAA 1997 provides that a non-share distribution is not a non-share dividend to the extent to which the company debits the distribution against the company's non-share capital account or the company's share capital account.

162. On the Exchange, MGL will debit the Issue Price of the BCN to its non-share capital account. Accordingly, the issue of MGL Ordinary Shares to the Holders of the BCN on the Exchange is not a non-share dividend, and will not be included in the assessable income of the Holders under subparagraph 44(1)(a)(ii) of the ITAA 1936.

163. Furthermore, the MGL Ordinary Shares will not be issued to the Holders of the BCN as shareholders of MGL. Therefore, it would not satisfy paragraphs (a) or (b) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936. This means that it will not be included in the assessable income of the Holders under subparagraph 44(1)(a)(i) of the ITAA 1936.

Section 45 of the ITAA 1936

164. 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 (but not all) shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

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

166. MGL expects to pay franked dividends to all its shareholders and franked distributions to all its holders of non-share equity interests consistently. Distributions paid on the BCN are expected to be franked at the same percentage that applies to MGL's Ordinary Shares (see paragraph 29). This means that minimally franked dividends will not be received by any MGL shareholders.

167. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to treat the value of the MGL Ordinary Shares issued to the Holders on the Exchange of the BCN as an unfrankable dividend paid by MGL to the Holders.

Section 45A of the ITAA 1936

168. 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 capital benefits (the advantaged shareholders) than other shareholders, and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

169. If these conditions are satisfied, the Commissioner may make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the capital benefits. The effect of such a determination is that the affected capital benefit is treated as an unfranked dividend.

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

171. The provision of a capital benefit includes the provision to the shareholder of shares in the company pursuant to paragraph 45A(3)(a) of the ITAA 1936. The issue of the MGL Ordinary Shares to the Holders on the Exchange of the BCN will constitute the provision of a capital benefit.

172. In the absence of any other factors, and based on the circumstances of the scheme, the issue of the MGL Ordinary Shares on the Exchange of the BCN will not be considered to be streaming the provision of capital benefits.

173. An Optional Redemption will involve the provision of a capital benefit pursuant to paragraph 45A(3)(b) of the ITAA 1936 (by virtue of subsection 45A(3A) of the ITAA 1936) as it will constitute a 'non-share capital return' (as defined in subsection 6(1) of the ITAA 1936 and section 974-125 of the ITAA 1997). The amount paid to the Holders on an Optional Redemption is limited to the amount of the Issue Price of the BCN being Redeemed. Any Distributions from the immediately preceding Distribution Payment Date and up to (but excluding) the Redemption Date will be paid in respect of the BCN being Redeemed, to the extent the conditions on the payment of Distributions (as described in paragraph 30 of this Ruling) are met.

174. Accordingly, under either situation, it cannot be said that Holders would derive a greater benefit from capital benefits than other MGL shareholders.

175. 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 of the BCN when the MGL Ordinary Shares are issued to the Holders on the Exchange of the BCN or when there is an Optional Redemption.

Section 45B of the ITAA 1936

176. Section 45B of the ITAA 1936 applies where under a scheme, a person is provided with a capital benefit in substitution for dividends and, having regard to the relevant circumstances of the scheme, there was a more than incidental purpose of enabling the relevant taxpayer to obtain a tax benefit.

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

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

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

- (i) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);

- (ii) under the scheme a taxpayer, who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit (paragraph 45B(2)(b) of the ITAA 1936); and
- (iii) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme, did so for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

180. The arrangement involving the issue of the BCN according to the BCN Terms, including the issue of the MGL Ordinary Shares to the Holders on the Exchange of the BCN, will constitute a scheme under which the Holders are provided with a capital benefit by MGL (paragraph 45B(5)(a) of the ITAA 1936).

181. Similarly, an Optional Redemption under the BCN Terms will also constitute a scheme under which the Holders are provided with a capital benefit by MGL (paragraph 45B(5)(b) of the ITAA 1936 by virtue of subsection 45B(7) of the ITAA 1936 as it will constitute a 'non-share capital return' (as defined in subsection 6(1) of the ITAA 1936 and section 974-125 of the ITAA 1997)).

182. In both situations, paragraph 45B(2)(a) of the ITAA 1936 is satisfied.

183. A taxpayer, who may or may not be the person provided with the capital benefit, must obtain a tax benefit under the scheme. Under subsection 45B(9) of the ITAA 1936, a relevant taxpayer obtains a tax benefit if:

- (a) an amount of tax payable, or
- (b) any other amount payable under the ITAA 1936 or the ITAA 1997,

by the relevant taxpayer would, apart from the operation of section 45B of the ITAA 1936,

- (c) be less than the amount that would have been payable, or
- (d) be payable at a later time than it would have been payable,

if the capital benefit had been an assessable dividend.

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

185. An Optional Redemption will not lead to the Holders deriving assessable income. Furthermore, as the Holders will only receive the Issue Price of each BCN being Redeemed or making a capital gain, and this Ruling only applies to entities who acquired their BCN by initial application under the Prospectus (having paid the Issue Price), an Optional Redemption will not lead to the Holders making a capital gain. By contrast, an assessable dividend would be included in the assessable income of the Holders.

186. Therefore, the Holders will generally obtain a tax benefit from the scheme. Paragraph 45B(2)(b) of the ITAA 1936 is satisfied.

187. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, it must be objectively concluded, having regard to the relevant circumstances of the scheme, that one or more of the persons that entered into or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose) of enabling the relevant taxpayers (the Holders) to obtain a tax benefit. A non-exhaustive list of the relevant circumstances of a scheme are listed in subsection 45B(8) of the ITAA 1936.

188. Having regard to the relevant circumstances of the scheme in subsection 45B(8) of the ITAA 1936, and on the basis of the information surrounding the issue of the BCN, the Commissioner has concluded that neither MGL, the Holders or any other person who entered into or carried out any part of the scheme did so for a more than incidental purpose of enabling the Holders to obtain a tax benefit.

189. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the capital benefit provided to the Holders of the BCN when the MGL Ordinary Shares are issued to the Holders on the Exchange of the BCN or when there is an Optional Redemption.

CGT event A1 happens on the disposal of MGL Ordinary Shares by a Sale Agent on behalf of a Holder

190. CGT event A1 happens when you dispose of a CGT asset (subsection 104-10(1) of the ITAA 1997). You dispose of a CGT asset if a change of ownership occurs from you to another entity, whether because of some act or event or by operation of law. However, a change of ownership does not occur if you stop being the legal owner of the asset but continue to be the beneficial owner (subsection 104-10(2) of the ITAA 1997).

191. Following the Exchange of the BCN, a Holder can elect for a Sale Agent to dispose (on behalf of the Holder) of their allocation of MGL Ordinary Shares and remit the net sale proceeds to the Holder. CGT event A1 will happen when the Sale Agent (on behalf of the Holder) enters into the contract for the sale of those MGL Ordinary Shares.

192. A Holder will make a capital gain from CGT event A1 happening if the capital proceeds from the sale of the MGL Ordinary Shares exceed their cost base. A Holder will make a capital loss if those capital proceeds are less than their reduced cost base (subsection 104-10(4) of the ITAA 1997).

193. The first element of the cost base and the reduced cost base of the MGL Ordinary Shares acquired by a Holder under the Exchange of the BCN, and sold on behalf of the Holder by the Sale Agent, will be determined by item 2 of the table in subsection 130-60(1) of the ITAA 1997.

194. The MGL Ordinary Shares acquired by a Holder under the Exchange of the BCN, and sold on behalf of the Holder by the Sale Agent, will be taken to have been acquired on the date determined by subsection 130-60(2) of the ITAA 1997.

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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
- convertible interests
- dividend imputation
- franking tax offset
- imputation benefits
- ordinary income
- qualified persons
- streaming of imputation benefit
- securities
- traditional securities

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