CR 2017/6 - Income tax: Insurance Australia Group Limited - issue of IAG Capital Notes

Class Ruling

Income tax: Insurance Australia Group Limited – issue of IAG Capital Notes

Contents Para

LEGALLY BINDING SECTION:

What this Ruling is about 1

Date of effect 11

Scheme 12

Ruling 55

NOT LEGALLY BINDING SECTION:

Appendix 1:

Explanation 77

Appendix 2:

Detailed contents list 160

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:

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

- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-25 of the ITAA 1997
- section 104-155 of the ITAA 1997
- section 109-10 of the ITAA 1997
- section 110-25 of the ITAA 1997
- section 110-55 of the ITAA 1997
- section 130-60 of the ITAA 1997
- section 204-30 of the ITAA 1997
- Subdivision 207-D of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-145 of the ITAA 1997
- subsection 974-75(1) of the ITAA 1997, and
- section 974-120 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is investors who are issued IAG Capital Notes (Notes) by Insurance Australia Group Limited (IAG) and who:

- are residents of Australia (within the meaning of subsection 6(1) of the ITAA 1936)
- acquire their Notes through the Reinvestment Offer, Broker Firm Offer or Institutional Offer by application in accordance with the Replacement Prospectus for the issue of IAG Capital Notes (Prospectus) that was lodged with the Australian Securities and Investments Commission on 29 November 2016
- hold their Notes on capital account. That is, the Notes are neither held 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), and
- are not subject to the Taxation of Financial Arrangements rules in Division 230 of the ITAA 1997 in relation to financial arrangements under the scheme.

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

4. In this Ruling, a person belonging to this class of entities is referred to as a Holder. A Holder for the purposes of this Ruling has the same meaning as in the Prospectus except as limited by the Class of entities to which the Ruling applies.

Qualifications

5. This Ruling does not cover the tax consequences of the Reinvestment Offer including the Pro Rata Dividend on Reinvested Convertible Preference Shares (CPS) paid as part of the Offer.

6. This Ruling does not consider the tax implications of:

- the Conversion of the Notes on a Trigger Event, or
- the Redemption (other than for the application of sections 45A and 45B of the ITAA 1936) or Resale of the Notes.

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

8. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

9. The class of entities to which this Ruling applies may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 12 to 54 below.

10. 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

11. This Ruling applies from 1 July 2016 to 30 June 2026. The Ruling continues to apply after 30 June 2026 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

12. The following description of the scheme is based on information provided by IAG. The Prospectus including the IAG Capital Notes Terms as contained in Appendix A of the Prospectus (Terms), or relevant parts of them form part of and are to be read with the description.

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

13. In this Ruling, unless otherwise indicated, capitalised terms take on the same meaning as in the Prospectus including the Terms.

14. IAG is an Australian resident company under the income tax laws of Australia and of no other jurisdiction.

15. IAG is an Authorised Non-Operating Holding Company for the purposes of the *Insurance Act 1973* regulated by the Australian Prudential Regulation Authority (APRA) which includes a requirement to maintain mandatory levels of Tier 1 Capital.

16. APRA confirmed that the Notes will constitute requisite Additional Tier 1 Capital in accordance with the regulatory requirements.

17. IAG applied for the Notes to be listed on the Australian Securities Exchange (ASX) under ASX Code 'IAGPD' and the Notes commenced trading on a deferred settlement basis on 23 December 2016.

18. IAG issued 3,773,728 Converting Preference Shares (CPS) on 1 May 2012. The CPS were issued pursuant to an offer which closed on 30 April 2012. Each CPS has a face value of $100.

The Offer of IAG Capital Notes

19. As disclosed in the Prospectus, IAG intends to raise $300 million through the issue of the Notes, with the ability to raise more or less (the Offer).

20. Applicants who apply for the Notes, and the corresponding process for lodging applications, are as follows:

- Reinvestment Offer – a holder of CPS, with a registered address in Australia on 18 November 2016, who chose to reinvest some or all of their CPS through the Reinvestment Offer
- Broker Firm Applicant – a retail or high-net-worth client of a Syndicate Broker who was invited to participate through the Broker Firm Offer, and

- Institutional Investor – an investor who was invited by IAG Joint Lead Managers to bid for the Notes in the Bookbuild who was not a Broker Firm Applicant nor a CPS holder, and who applied through the Institutional Offer.

21. The Prospectus states that no action was taken to register or qualify the Notes or the Offer or to otherwise permit a public offering of the Notes in any jurisdiction outside Australia.

Reasons for issuing IAG Capital Notes

22. The Offer is part of IAG's ongoing prudential funding and capital management strategy. IAG will use the proceeds of the Offer to refinance some CPS and for general corporate purposes.

Terms of IAG Capital Notes

23. The Notes are described in the Prospectus as fully paid, convertible, redeemable and resaleable, perpetual, unsecured, subordinated debt obligations issued by IAG.

24. The issue price of each Note is $100.

25. A Holder will not have voting rights at a general meeting of IAG in respect of any Notes held.

Distribution calculation

26. Subject to the conditions outlined in paragraphs 29 to 31 below, Holders are entitled to receive on the relevant Distribution Payment Date a cash distribution (Distribution) calculated using the following formula:

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

where:

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

Distribution Rate = (Bank Bill Rate + Margin) × (1 – T)

where:

Bank Bill Rate (expressed as a percentage per annum) means, for a Distribution Period, the rate for prime bank eligible securities having a tenor of 3 months, which is designated as the 'AVG MID' on the Reuters Screen BBSW Page (or any page which replaces that page) at approximately 10:15am, Sydney time (or such other time at which such rate customarily appears on that page) on the relevant day (Publication Time), on the first Business Day of the Distribution Period. However, if such rate does not appear on the Reuters Screen BBSW Page (or any page which replaces that page) by 10.30am, Sydney time, on that day (or such other time that is 15 minutes after the then prevailing Publication Time), or if it does appear but IAG determines that there is an obvious error in that rate, 'Bank Bill Rate' means the rate determined by IAG having regard to comparable indices then available;

Margin (expressed as a percentage per annum) means the margin determined under the Bookbuild;

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

N means in respect of:

(a) the first Distribution Payment Date, the number of days from (and including) the Issue Date until (but not including) the first Distribution Payment Date; and

(b) each subsequent Distribution Payment Date, the number of days from (and including) the preceding Distribution Payment Date until (but not including) the relevant Distribution Payment Date.

27. The Distribution Payment Dates are each 15 March, 15 June, 15 September and 15 December commencing on 15 March 2017 until (but not including) the date on which a Redemption or Conversion of the Note occurs in accordance with the Terms, and each date on which an Exchange of the Note occurs, other than a Conversion on a Trigger Event Date, in each case in accordance with the Terms. IAG will debit each distribution on the Notes to its Retained earnings.

28. IAG expects to fully frank Distributions it makes on the Notes. However, if any Distribution is not fully franked, the Distribution will be grossed-up by a factor which reflects the Australian corporate tax rate, as determined by the formula in clause 3.2 of the Terms.

Distribution payment conditions

29. Each Distribution is subject to:

- IAG's absolute discretion, and
- no payment condition existing in respect of the relevant Distribution Payment Date.

30. A payment condition will exist if:

- paying the Distribution would result in IAG or the IAG Level 2 Insurance Group not complying with APRA's capital adequacy requirements (unless APRA otherwise approves the Distribution in writing)
- paying the Distribution would result in IAG becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*, or
- APRA objects to the payment.

31. A Distribution is only payable on a Distribution Payment Date to those persons registered as Holders on the Record Date for that Distribution.

32. Distributions are non-cumulative. If all or any part of a Distribution is not paid, IAG is not liable to pay the unpaid amount of the Distribution and Holders will not have any claim or entitlement in respect of such non-payment and such non-payment will not constitute an event of default.

33. No interest will accrue on any unpaid Distributions and Holders will not have any claim or entitlement in respect of interest on any unpaid Distributions.

Restrictions in the case of non-payment of Distributions

34. If for any reason a Distribution was not paid in full on a Distribution Payment Date (the Relevant Distribution Payment Date), IAG must not, without approval of a Special Resolution, until and including the next Distribution Payment Date:

- declare or determine to pay, or pay, an Ordinary Share Dividend, or
- undertake any buy-back or capital reduction,

unless the Distribution is paid in full within 3 Business Days of the Relevant Distribution Payment Date.

Mandatory Conversion

35. Subject to clauses 5, 6 and 7 of the Terms, on the Mandatory Conversion Date, 16 June 2025 or each Relevant Date, IAG must Convert all (but not some) Notes on issue into IAG Ordinary Shares on that date in accordance with clauses 4 and 8 of the Terms.

36. The Mandatory Conversion Date is the earliest date to occur of:

- 16 June 2025 (which is the Scheduled Mandatory Conversion Date), and
- the first Distribution Payment Date after16 June 2025 (each a Relevant Date),

on which the Mandatory Conversion Conditions are satisfied.

37. The First, Second and Third Mandatory Conversion Conditions which must each be satisfied for each Relevant Date are:

- the average of the daily volume weighted average sale prices (VWAP) of Ordinary Shares sold on the ASX on the 25th Business Day on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Date (the First Test Date) is greater than 57.5000% of the Issue Date VWAP
- the VWAP during the period of 20 Business Days on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Date (the Second Test Period) is greater than 50.5050% of the Issue Date VWAP, and
- no Delisting Event applies in respect of the Relevant Date, being either:
  - IAG is delisted from ASX
  - IAG's Ordinary Shares were suspended from trading for a certain time, or
  - IAG is prevented by applicable law or order of any court or action of any government authority or any other reason from converting the Notes.

Trigger Event Conversion

38. Conversion of the Notes may occur at a time before a Scheduled Mandatory Conversion Date as a result of:

- an Acquisition Event, or
- a Non-Viability Trigger Event.

39. An Acquisition Event happens when:

(a) a takeover bid is made to acquire all or some Ordinary Shares and the offer is, or becomes, unconditional and:

(i) the bidder has a relevant interest in more than 50% of IAG Ordinary Shares on issue, or

(ii) the Directors issue a statement that at least a majority of those Directors who are eligible to do so recommend acceptance of the offer (which may be stated to be in the absence of a higher offer), or

(b) a court approves a scheme of arrangement which, when implemented, will result in a person other than IAG having a relevant interest in more than 50% of the Ordinary Shares,

and all regulatory approvals necessary for the acquisition to occur are obtained.

40. A Non-Viability Trigger Event means the earlier of:

(a) IAG receives a written determination from APRA that conversion or write off of Relevant Securities is necessary because, without it, APRA considers that IAG would become non-viable, or

(b) IAG is notified of a determination made by APRA in writing that without a public sector injection of capital, or equivalent support, IAG would become non-viable.

41. A Conversion following a Non-Viability Trigger Event will occur immediately and is not subject to any conditions. The number of Ordinary Shares that Holders receive on a Conversion will not be greater than the Maximum Conversion Number. If the Notes are not Converted within 5 Business Days of a Trigger Event for any reason they will be Written-Off, which means that all rights in relation to those Notes will be terminated, and those Holders will not get their capital repaid or receive compensation.

Optional Exchange

42. At the Optional Exchange Date 15 June 2023, IAG may choose to:

- Convert the Notes into IAG Ordinary Shares in accordance with clause 8 of the Terms
- Redeem the Notes for cash in accordance with clause 9 of the Terms, or
- Resell the Notes for cash payable by a nominated third party purchaser in accordance with clause 10 of the Terms.

43. IAG must obtain APRA's written approval and specify which of the above method or combination of methods it will use to exchange the Notes.

44. IAG may not elect Conversion as the method of exchange if the VWAP during the two Business Days prior to the date when the Exchange Notice is given is less than or equal to 23.0000% of the Issue Date VWAP or a Delisting Event applies to that date.

Conversion

45. 'Conversion' is defined as the allotment and issue of IAG Ordinary Shares and the termination of the Holder's rights in relation to the Note or Notes, in each case in accordance with clause 8 of the Terms.

46. On Conversion:

- Each Holder will be allotted and issued a number (the Conversion Number) of IAG Ordinary Shares to the value of $101 in respect of each Note held by the Holder, and
- each Holder's rights (including to payment of Redemption Price and Distributions other than the Distribution, if any, payable on a date (other than a Trigger Event Date) on which Conversion is required to occur) in relation to each Note that is Converted will be immediately and irrevocably terminated in full for an amount equal to the Issue Price of the Note ($100) and IAG will apply that amount as payment for subscription for IAG Ordinary Shares which will be allotted and issued under clause 8.1(a) of the Terms.

47. The Conversion Number (or number of IAG Ordinary Shares issued for each Note) is calculated according to the formula set out in the Terms which provides for approximately $101 worth of IAG Ordinary Shares per Note, subject to the Conversion Number not exceeding the Maximum Conversion Number.

Redemption

48. IAG may (subject to APRA giving its prior written approval and compliance with clause 5.3(b) of the Terms) elect to Redeem the Notes in accordance with the Terms.

49. The Notes will be redeemed by payment on the Exchange Date of an amount equal to the Issue Price ($100 per Note) to the Holder. Redemption may occur even if IAG, in its absolute discretion, does not make a Distribution payment for the final (or any other) Distribution Period.

50. On the Exchange Date, Holders will only have the right to receive the Redemption Price ($100 per Note) payable in respect of the Notes in accordance with the Terms and upon payment of the price, all other rights conferred, or restrictions imposed, by the Notes will no longer have effect.

Resale

51. IAG may (subject to APRA approval) elect to Resell the Notes in accordance with the Terms.

52. Each Holder is taken to irrevocably offer to sell the Notes that are subject of a Resale to the Nominated Purchaser or Nominated Purchasers on the Exchange Date for the Resale Price.

Other matters

53. The Ruling is made on the basis that:

(a) IAG will frank the Distributions on the Notes at its benchmark franking percentage for the franking period in which the Distributions are made.

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

(c) IAG's share capital account will not become tainted by way of issue of the Notes or IAG Ordinary Shares on Conversion of the Notes within the meaning of Subdivision 197-A of the ITAA 1997.

(d) IAG Ordinary Shares issued in the event of Conversion of the Notes will be equity interests in IAG pursuant to Division 974 of the ITAA 1997.

(e) The majority of the Holders of the Notes will be residents of Australia for tax purposes, although an insignificant number of Notes may be held by non-residents.

(f) The Notes will be treated as a liability for Australian International Financial Reporting Standard purposes.

(g) For the purposes of determining whether a Holder is a 'qualified person' under Division 1A of former Part IIIAA of the ITAA 1936 in relation to the Distributions, neither a Holder nor an associate of a Holder will take any positions (apart from the holding of the Notes) in relation to their Notes and will neither be under an obligation, nor be likely, to make a related payment in relation to the Distributions.

(h) The Holders, or their associates, will not make any related payments (within the meaning of former section 160APHN of the ITAA 1936) in relation to the Distributions on the Notes.

(i) Holders in receipt of Distributions on the Notes will have held their Notes for a period of at least 90 days (excluding the day of disposal), within the period beginning on the day after the day on which the Holder acquired the Notes and ending on the 90th day after the day on which the Notes go ex-distribution.

(j) Distributions on the Notes will not be debited against IAG's share capital or non-share capital accounts.

(k) The dividend payout ratios or the franking credits in relation to the ordinary or preference share capital or non-share capital of IAG are not expected to change materially as a result of the issue of the Notes.

(l) Immediately before payment of a Distribution on the Notes, IAG will have sufficient available frankable profits (worked out under sections 215-15 and 215-20 of the ITAA 1997) to pay the Distribution.

(m) On Conversion, IAG will debit the Issue Price of the Notes to its non-share capital account.

(n) On the date of Conversion of the Notes into IAG Ordinary Shares, the rights and obligations attached to the IAG Ordinary Shares are the same as those contained in the Constitution of IAG.

54. IAG is a non-operating holding company and substantially all its assets are made up of shares in, or other claims on, its subsidiaries. Accordingly, any claims of Holders against IAG will be limited to the value of IAG's residual claims to the net assets (if any) of its subsidiaries, after all liabilities, including to policyholders, are discharged or provided for.

Ruling

IAG Capital Notes are non-share equity interests

55. Each Note is an 'equity interest' in IAG pursuant to Division 974 of the ITAA 1997 and is a 'non-share equity interest' in IAG as the term is defined in subsection 995-1(1) of the ITAA 1997.

Acquisition time of IAG Notes

56. A Holder will acquire their Notes on 22 December 2016, being the date the contract for the issue of the Notes is entered into (item 2 of the table in section 109-10 of the ITAA 1997).

Cost base and reduced cost base of IAG Capital Notes

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

Distributions on the Notes are frankable

58. Distributions on the Notes will be frankable distributions pursuant to section 202-40 of the ITAA 1997 where the Distributions are not unfrankable pursuant to section 202-45 of the ITAA 1997.

Inclusion of Distributions and franking credits in assessable income

59. Distributions paid in respect of each Note are non-share dividends under section 974-120 of the ITAA 1997 and are included in the Holders assessable income (subparagraph 44(1)(a)(ii) of the ITAA 1936).

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

Entitlement to a tax offset

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

Exempt income or non-assessable non-exempt income

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

Franking credit subject to the refundable tax offset rules

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

Imputation benefits – streaming of imputation benefits

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

Section 177EA of the ITAA 1936

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

Gross-up and tax offset denied in certain circumstances

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

Each Note is not a traditional security

67. Section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of Holders upon disposal or redemption of their Notes.

68. Section 70B of the ITAA 1936 will not apply to allow a deduction to Holders upon disposal or redemption of their Notes.

Conversion of Notes – CGT implications

69. CGT event C2 (section 104-25 of the ITAA 1997) will happen to Holders on Conversion of their Notes for IAG Ordinary Shares. Conversion is when the Notes (a convertible interest) are converted into Ordinary Shares.

70. Any capital gain or capital loss that a Holder makes as a result of CGT event C2 happening on Conversion of the Notes will be disregarded (subsection 130-60(3) of the ITAA 1997).

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

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

Acquisition time of IAG Ordinary Shares on Conversion

72. IAG Ordinary Shares acquired on Conversion of the Notes (being convertible interests) are taken to be acquired when the Conversion happens on the relevant Conversion Date (subsection 130-60(2) of the ITAA 1997).

Allotment of IAG Ordinary Shares on Conversion not a Non-Share Dividend

73. Other than in respect of a Distribution paid on the Conversion Date, a Holder will not be taken to have received a dividend within the meaning of subsection 6(1) of the ITAA 1936 nor a non-share dividend under section 974-120 of the ITAA 1997 as a result of Conversion of the Notes.

Section 45 of the ITAA 1936

74. Section 45 of the ITAA 1936 will not apply to treat the IAG Ordinary Shares issued on Conversion as an unfrankable dividend paid by IAG.

Section 45A of the ITAA 1936

75. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or part of, a non-share capital benefit that arises on Conversion or Redemption of the Notes as an unfranked dividend in the hands of Holders.

Section 45B of the ITAA 1936

76. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or part of, a non-share capital benefit that arises on Conversion or Redemption of the Notes as an unfranked dividend in the hands of Holders.

Commissioner of Taxation
25 January 2017

Appendix 1 – Explanation

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

IAG Capital Notes are non-share equity interests

77. Each Note will or may convert into IAG Ordinary Shares (the shares are equity interests under item 1 of the table in subsection 974-75(1) of the ITAA 1997).

78. The Notes are not debt interests pursuant to subsection 974-15(1) and section 974-20 of the ITAA 1997.

79. The Notes are 'equity interests' in IAG pursuant to Division 974 of the ITAA 1997 and are 'non-share equity interests' in IAG as the term is defined in subsection 995-1(1) of the ITAA 1997 (subsection 974-70(1) and item 1 of the table in subsection 974-75(1) of the ITAA 1997).

Acquisition time of the Notes

80. An equity interest that is issued or allotted by a company is acquired when the contract is entered into or, if there is no contract, when the equity interests are issued or allotted (item 2 of the table in section 109-10 of the ITAA 1997).

81. The Notes are non-share equity interests in IAG. When an investor's application for the Notes is accepted by IAG, this results in the formation of a contract for the issue of Notes 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 Notes on 22 December 2016, being the date on which the contract for the issue of the Notes is entered into.

Cost base and reduced cost base of IAG Capital Notes

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

83. The issue price of each Note is $100. Accordingly, when the Notes are issued, the first element of the cost base and reduced cost base of each IAG Capital Note for the Holders will include $100.

Distributions on the Notes are frankable

84. Distributions on the Notes will be entirely frankable distributions pursuant to section 202-40 of the ITAA 1997 where the circumstances of the Distributions do not render the Distributions as

wholly or partly unfrankable pursuant to section 202-45 of the ITAA 1997.

Inclusion of Distributions and franking credits in assessable income

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

86. As the Notes are 'non-share equity interests', 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 that it applies to a share. Holders are 'equity holders' 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.

87. Distributions paid in respect of the Notes are non-share dividends under section 974-120 of the ITAA 1997. Accordingly, Holders must include Distributions received in respect of the Notes in their assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

88. Distributions on the Notes are expected to be franked. If a company makes a franked distribution to another entity, subsection 207-20(1) of the ITAA 1997 requires that the assessable income of the recipient entity includes the amount of the franking credit on the distribution in addition to the amount of the distribution. Subsection 207-20(2) of the ITAA 1997 provides that the recipient entity is entitled to a tax offset equal to the franking credit on the distribution.

89. In accordance with subsection 207-20(1) of the ITAA 1997, a Holder is required to include any franking credit attached to a Distribution received in their assessable income for the income year in which the Distribution is made.

Entitlement to a tax offset

90. In accordance with subsection 207-20(2) of the ITAA 1997, Holders are entitled to receive a tax offset equal to the franking credit which is included in their assessable income in respect of Distributions they receive.

Franking credit subject to the refundable tax offset rules

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

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

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

Exempt income or non-assessable non-exempt income

94. If the Distribution is exempt income or non-assessable non-exempt income in the hands of the Holder and none of the exceptions in Subdivision 207-E of the ITAA 1997 apply, then:

- the amount of any franking credit on the Distribution is not included in the assessable income of the Holder, and
- the Holder is not entitled to a tax offset under Division 207 of the ITAA 1997 (Subdivision 207-D of the ITAA 1997).

Imputation benefits – streaming of imputation benefits

95. Section 204-30 of the ITAA 1997 applies to:

- non-share equity interests such as the Notes in the same way as it applies to membership interests such as shares (which are not also debt interests), and
- equity holders such as the Holders in the same way as it applies to members,

(section 215-1 of the ITAA 1997 and definition of 'imputation system' in section 995-1).

96. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that certain shareholders, referred to as favoured members, obtain imputation benefits, and other shareholders, referred to as disadvantaged members, obtain lesser or no imputation benefits, whether or not they receive other benefits. The favoured members are those that derive a greater benefit from imputation benefits than disadvantaged members.

97. The Commissioner confirms that should section 204-30 of the ITAA 1997 apply to a distribution made on the Notes, a determination will not be made under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received by a Holder in relation to the Distribution.

Section 177EA of the ITAA 1936

98. Section 177EA of the ITAA 1936 applies to:

- non-share equity interests such as the Notes in the same way as it applies to membership interests such as shares (which are not also debt interests)
- equity holders such as the Holders in the same way as it applies to members, and
- non-share dividends in the same way as it applies to dividends,

(subsection 177EA(12) of the ITAA 1936).

99. 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 shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares.

100. The Commissioner confirms that, should section 177EA of the ITAA 1936 apply to a non-share dividend received by Holders on the Notes, a determination will not be made under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by Holders in relation to the non-share dividend.

Gross-up and tax offset denied in certain circumstances

101. 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 is relevant to the Holders that are subject to this Ruling.

102. Pursuant to subsection 207-145(1) of the ITAA 1997, the adjustment occurs where a franked distribution is made to an entity in one or more of circumstances including:

- 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), or

- the distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d) of the ITAA 1997).

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

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

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

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

107. A Holder will be a 'qualified person' in relation to a Distribution received in respect of their Notes, provided that:

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

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

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

110. In accordance with former subsection 160APHJ(2) of the ITAA 1936, a position in relation to a Note 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 it:

> 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 price relationship.

111. 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).

112. Under the Resale mechanics, IAG can elect to require some or all of the Holders to sell their Notes to a Purchaser. The Purchaser, until selected by IAG, has no right or ability to trigger Resale of the Notes from the Holders.

113. IAG is not required to exercise the Resale mechanics. It follows that the Resale mechanics is an option that is held by IAG, as the issuer, and not by a third party. The Resale mechanics therefore does not represent a separate position in relation to the Notes for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.

114. Similarly, although the Conversion mechanics will affect the conversion of the Notes for IAG Ordinary Shares, the Conversion will not represent a separate position for the purposes of Division 1A of former Part IIIAA of the ITAA 1936. This is because the Holders do not have the right to elect Conversion.

115. Therefore, the Commissioner has concluded that the Resale and Conversion mechanics will not of themselves affect a Holder's risks of loss or opportunities for gain in respect of the Notes.

116. A distribution is taken to be made as part of a dividend stripping operation, pursuant to section 207-145 of the ITAA 1997, where the distribution arose out of, or was made in the course of, a scheme or substantially similar arrangement that was in the nature of dividend stripping.

117. Based on the information provided by IAG, there is no indication that the offering of the Notes and the associated payment of franked Distributions to Holders in any way constitutes a dividend stripping arrangement.

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

Each IAG Capital Note will not be a traditional security

119. A traditional security is defined in subsection 26BB(1) of the ITAA 1936 as a security held by the taxpayer which the taxpayer acquired after 10 May 1989, is not trading stock of the taxpayer, and either does not have an eligible return, or has an eligible return that satisfies the conditions listed in subparagraph (b)(ii) of the definition of traditional security in subsection 26BB(1) of the ITAA 1936.

120. The term 'security' is defined in subsection 26BB(1) of the ITAA 1936 by reference to subsection 159GP(1) of the ITAA 1936. Pursuant to subsection 159GP(1), 'security' means:

> (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
>
> (b) a deposit with a bank or other financial institution;
>
> (c) a secured or unsecured loan; or
>
> (d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

121. An IAG Capital Note is not stock, a bond, debenture, certificate of entitlement, bill of exchange, or a promissory note.

122. 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 *Income tax; traditional securities*).

123. Paragraphs (b) and (c) of the definition of security do not apply because the Notes are neither a deposit with a bank or other financial institution, nor secured or unsecured loans.

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

125. The Terms do not evidence a liability by IAG to pay an amount or amounts to Holders of the Notes during the term of the Notes or at maturity.

126. The Notes are perpetual and Holders do not have a right to require Redemption.

127. The payment by IAG of Distributions is subject to the Distribution Payment Conditions. Distributions are discretionary and non-cumulative. If a Distribution is not paid, IAG is not liable to pay the Distribution and Holders will not have any claim in respect of non-payment.

128. Upon Conversion, IAG will allot and issue a number of IAG Ordinary Shares based on a formula set out in the Terms for each Note held by the Holder. Each Holder's rights in relation to each Note which is converted are immediately and irrevocably terminated for an amount equal to the Face Value and IAG will apply that amount by way of paying the subscription price for IAG Ordinary Shares issued to Holders. IAG cannot be said to be liable to pay an amount under the Terms of the Notes pursuant to the Conversion.

129. Early Redemption of the Notes is possible. However, it is at the option of IAG or will only occur upon the happening of certain events and requires the prior written approval of APRA. This does not render IAG liable to pay an amount.

130. IAG will not become liable to pay an amount under the Notes upon a wind-up as it is expected that the Notes will be converted into Ordinary Shares pursuant to a Trigger Event (in which case any distribution would be made to the Holders as IAG ordinary shareholders as opposed to under the Terms), or the Holders' rights will be terminated where IAG is unable to issue IAG Ordinary Shares within the time stated in the Terms.

131. As a Note is not a security within the meaning of subsection 159GP(1) of the ITAA 1936, the Notes are not traditional securities under subsection 26BB(1) of the ITAA 1936.

132. Section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of the Holder upon disposal or redemption of the Notes.

133. Section 70B of the ITAA 1936 will not apply to allow a deduction to Holders upon disposal or redemption of their Notes.

Notes are convertible interests

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

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

- the interest must be or may be converted into another interest (paragraph 974-165(a) of the ITAA 1997), or

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

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

Conversion of Notes – CGT implications

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

138. The Notes are convertible interests. Conversion of the Notes for IAG Ordinary Shares constitutes the conversion of a convertible interest.

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

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

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

Acquisition time of IAG Ordinary Shares acquired on Conversion

141. IAG Ordinary Shares acquired on Conversion of the Notes (being convertible interests) are taken to be acquired when the Conversion happens on the relevant Conversion Date (subsection 130-60(2) of the ITAA 1997).

Allotment of Ordinary Shares on Conversion not a Non-Share Dividend

142. The issue of IAG Ordinary Shares to Holders on Conversion is a distribution of property made to holders of non-share equity interests and a non-share distribution under subparagraph 974-115(b)(ii) of the ITAA 1997. A non-share distribution is a

non-share dividend under subsection 974-120(1) of the ITAA 1997, subject to the application of subsection 974-120(2) of the ITAA 1997.

143. 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 share capital account or non-share capital account.

144. On Conversion, IAG will debit the Face Value of the Notes to its non-share capital account. Accordingly, the issue of IAG Ordinary Shares on Conversion will not be a non-share dividend and will not be included in a Holder's assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

145. Furthermore, the IAG Ordinary Shares will not be issued to the Holders of Notes as shareholders of IAG. Accordingly, the issue of the IAG Ordinary Shares will 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.

Sections 45, 45A and 45B of the ITAA 1936

146. By operation of section 43B of the ITAA 1936, sections 45, 45A and 45B of the ITAA 1936 each apply to:

- non-share equity interests in the same way as to shares
- a non-share equity holder in the same way as to a shareholder, and
- a non-share dividend in the same way as to a dividend.

Section 45 of the ITAA 1936

147. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are franked to less than 10%.

148. IAG has consistently paid and will continue to pay fully franked dividends/distributions to all its shareholders and equity holders (including the Holders) to the extent of the franking credits in its franking account.

149. 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 issue of IAG Ordinary Shares on Conversion as an unfrankable dividend in the hands of Holders.

Section 45A of the ITAA 1936

150. Section 45A of the ITAA 1936 applies in circumstances where a company streams the provision of capital benefits to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

151. A provision of capital benefits includes the provision to the shareholder of shares in the company pursuant to paragraph 45A(3)(a) of the ITAA 1936. The issue of IAG Ordinary Shares to Holders on Conversion of the Notes will constitute the provision of capital benefits.

152. The issue of IAG Ordinary Shares on Conversion of the Notes is in effect a restatement of the Holder's interest in the capital of IAG. In the absence of any other factors that would contribute to an alternative conclusion, this would not constitute streaming of capital benefits.

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

154. Accordingly, it cannot be said that Holders would derive a greater benefit from capital benefits than other IAG shareholders and IAG non-share equity holders. Therefore, the issue of IAG Ordinary Shares on Conversion or the Redemption of the Notes will not trigger the application of section 45A of the ITAA 1936.

Section 45B of the ITAA 1936

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

156. The issue of IAG Ordinary Shares to Holders on Conversion will constitute a scheme under which the Holders are provided with a capital benefit by IAG (paragraph 45B(5)(a) of the ITAA 1936). Similarly, Redemption of the Notes will also constitute a scheme under which the Holders are provided with a capital benefit by IAG (paragraph 45B(5)(b) of the ITAA 1936 and subsection 45B(7) of the ITAA 1936).

157. For the provision to apply, among other things, paragraph 45B(2)(c) of the ITAA 1936 requires that, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit. A non-exhaustive list of relevant circumstances of the scheme are provided in subsection 45B(8) of the ITAA 1936.

158. Having regard to the relevant circumstances surrounding the issue of IAG Ordinary Shares on Conversion and Redemption of the Notes, it cannot be concluded that IAG, the Holders or any other person entered into or carried out the Conversion or Redemption of Notes for the purpose of enabling Holders to obtain a capital benefit.

159. Accordingly, section 45B does not apply in respect of issue of IAG Ordinary Shares to Holders on Conversion or Redemption of the Notes.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	**1**
Relevant provision(s)	2
Class of entities	3
Qualifications	5
Date of effect	**11**
Scheme	**12**
The Offer of IAG Capital Notes	19
Reasons for issuing IAG Capital Notes	22
Terms of IAG Capital Notes	23
Distribution calculation	26
Distribution payment conditions	29
Restrictions in the case of non-payment of Distributions	34
Mandatory Conversion	35
Trigger Event Conversion	38
Optional Exchange	42
Conversion	45
Redemption	48
Resale	51
Other matters	53
Ruling	**55**
IAG Capital Notes are non-share equity interest	55
Acquisition time of IAG Notes	56
Cost base and reduced cost base of IAG Capital Notes	57
Distribution on the Notes are frankable	58
Inclusion of Distributions and franking credits in assessable income	59
Entitlement to a tax offset	61
Exempt income or non-assessable non-exempt income	62
Franking credit subject to the refundable tax offset rules	63
Imputation benefits – streaming of imputation benefits	64
Section 177EA of the ITAA 1936	65
Gross-up and tax offset denied in certain circumstances	66

Each Note is not a traditional security 67
Conversion of Notes – CGT implications 69
Cost base and reduced cost base of IAG Ordinary Shares acquired on Conversion 71
Acquisition time of IAG Ordinary Shares on Conversion 72
Allotment of IAG Ordinary Shares on Conversion not a Non-Share Divided 73
Section 45 of the ITAA 1936 74
Section 45A of the ITAA 1936 75
Section 45B of the ITAA 1936 76
Appendix 1 – Explanation 77
IAG Capital Notes are non-share equity interests 77
Acquisition time of the Notes 80
Cost base and reduced cost base of IAG Capital Notes 82
Distribution on the Notes are frankable 84
Inclusion of Distributions and franking credits in assessable income 85
Entitlement to a tax offset 90
Franking credit subject to the refundable tax offset rules 91
Exempt income or non-assessable non-exempt income 94
Imputation benefits – streaming of imputation benefits 95
Section 177EA of the ITAA 1936 98
Gross-up and tax offset denied in certain circumstances 101
Each IAG Capital Note will not be a traditional security 119
Notes are convertible interests 134
Conversion of Notes – CGT implications 137
Cost base and reduced cost base of IAG Ordinary Shares acquired on Conversion 140
Acquisition time of IAG Ordinary Shares acquired on Conversion 141
Allotment of Ordinary Shares on Conversion not a Non-Share Dividend 142
Sections 45, 45A and 45B of the ITAA 1936 146
Section 45 of the ITAA 1936 147
Section 45A of the ITAA 1936 150
Section 45B of the ITAA 1936 155
Appendix 2 – Detailed contents list 160

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Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1999

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