


# ***CR 2017/90 - Income tax: Warwick Credit Union Ltd - Capital Notes***

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## Class Ruling

### Income tax: Warwick Credit Union Ltd – 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.

### Summary – What this ruling is about

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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 provisions

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 45C of the ITAA 1936
- section 159GP of the ITAA 1936
- section 177EA of the ITAA 1936

- Division 67 of the ITAA 1997 *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-25 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
- section 207-20 of the ITAA 1997
- section 207-145 of the ITAA 1997
- section 207-155 of the ITAA 1997
- section 974-75 of the ITAA 1997
- section 974-120 of the ITAA 1997
- subsection 995-1(1) of the ITAA 1997.

## Class of entities

3. The class of entities to which this Ruling applies are investors (referred to as Holders) who acquire fully paid, unsecured, subordinated, convertible notes issued by the Warwick Credit Union Ltd (Warwick) called the Warwick Capital Notes (Notes) and who:

- are Australian residents (within the meaning of subsection 6(1) of the ITAA 1936) during the period in which they hold the Notes
- hold the Notes 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 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. The class of entities to which this Ruling applies does not extend to Holders of the Notes who did not acquire their Notes by initial application under the Replacement Offer Information Statement dated 13 November 2017 issued by Warwick.

## Qualifications

5. This Ruling does not deal with how the taxation law applies to Holders who hold their Notes as trading stock or revenue assets.

6. 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.

7. This Ruling does not deal with how the taxation law applies to Warwick in relation to the issue of the Notes.

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

9. 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 12 to 47 of this Ruling.

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**

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11. This Ruling applies from 1 July 2017 to 30 June 2027. The Ruling continues to apply after 30 June 2027 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**

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12. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for Class Ruling dated 9 August 2017
- Replacement Offer Information Statement dated 13 November 2017 for the issue of the Notes
- the Terms of the Notes (Note Terms) in the Offer Information Statement
- the Terms of the Mutual Equity Interests (MEIs) (MEI Terms) in the Offer Information Statement
- the Note Deed Poll

- Warwick's Constitution, and
- further correspondence and additional information provided by Warwick.

**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 defined, capitalised terms take their meaning as specified in the Replacement Offer Information Statement.

## **Background**

14. Warwick is an authorised deposit-taking institution (ADI) regulated by the Australian Prudential Regulation Authority (APRA).

15. The Replacement Offer Information Statement relates to the offer of the Notes to raise \$10,000,000 (the Offer) with the ability to raise a higher or lower amount, in order to satisfy Warwick's regulatory capital requirements. The funds raised from the issue of the Notes will be used for the general business purposes of Warwick in Australia.

16. APRA has confirmed that the Notes will be treated as Additional Tier 1 Capital under the Prudential Standard APS 111 implemented under the Basel III capital reforms (commencing from 1 January 2013).

17. The issue date for the Notes is 15 December 2017. The Notes will not be listed on the Australian Securities Exchange or any other exchange.

## **Main features of the Notes**

18. The Notes are fully paid, perpetual, unsecured, subordinated, convertible notes issued by Warwick.

19. The issue price of each Note is AUD \$100 and will be fully paid on issue.

20. Each Note has a Face Value of AUD \$100 (Face Value).

21. A Holder will not have any rights under the Notes to attend or vote at any general meetings of the Warwick shareholders.

22. The Notes are subject to Conversion and Redemption. In particular, some or all of the Notes may be Converted or Written off if a Non-Viability Trigger Event occurs.

23. There is no certainty that the Notes will be Converted or Redeemed as a Non-Viability Trigger Event may not occur and in any event, APRA's written approval may not be granted and Warwick may be unwilling to Convert or Redeem the Notes.

24. Holders of the Notes do not have a right to require redemption of the Notes.

### **Distribution calculation**

25. Subject to the conditions outlined at paragraphs 28 to 29 each Note entitles the Holder to receive on the relevant Distribution Payment Date, a distribution on the Face Value of the Notes (Distribution), calculated using the following formula:

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

where:

**Distribution Rate** is calculated using the following formula:

$$\text{Distribution Rate} = (\text{Market Rate} + \text{Margin}) \times \text{Franking Adjustment Factor}$$

where:

**Market Rate** (expressed as a percentage per annum) means, for a Distribution Period, the rate for prime bank eligible securities having a 3 month tenor which is designated as 'AVG MID' on the Thomson Reuters Screen BBSW page (or any designation which replaces that designation on that page or any page which replaces that page) at approximately 10:15am on the first Business Day of the Distribution Period. However, if such rate does not appear on Thomson Reuters Screen BBSW page by 10:30am on that day, or if it does appear but Warwick determines that there is an obvious error in that rate, 'Market Rate' (for that day) will be the rate determined by Warwick having regard to comparable indices then available.

**Margin** means 6.30% per annum; and

**Franking Adjustment Factor** means:

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

where:

- **F** means the Franking Rate
- **T** means the Tax Rate

**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.

26. Distributions are expected to be fully franked.
27. Subject to the conditions in paragraph 28, Distributions will be payable in arrear on the Distribution Payment Dates of 15 March, 15 June, 15 September and 15 December of each year, commencing on 15 March 2018 until the Notes are Converted or Redeemed. Distributions are also payable on the date on which a Conversion or Redemption of the Notes occurs.

## **Distribution conditions**

28. The payment of any Distribution on a Distribution Payment date is subject to:
- Warwick's absolute discretion
  - the payment not resulting in a breach of Warwick's capital requirements under the current Prudential Standards at the time of the payment
  - the payment of the Distribution not resulting in Warwick becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001* (Cth), and
  - APRA not otherwise objecting to the payment of the Distribution.
29. Distributions are non-cumulative and interest does not accrue on any unpaid Distributions. Distributions are only payable in cash. If a distribution is not paid because the relevant conditions are not satisfied or because of any other reason, Warwick has no liability to pay such Distribution to the Holder and the Holder has no claim or right to apply for winding up in respect of such non-payment. Non-payment of a Distribution does not constitute an event of default.
30. Subject to certain exceptions, where a Distribution is not paid in full on a Distribution Payment date, Warwick is restricted from declaring or determining to pay or pay a dividend in relation to any MEIs (assuming that MEIs are on issue at that time) without the approval of a Special Resolution.

## **Conversion on Trigger Event**

31. Conversion of the Notes may occur on the occurrence of a Non-viability Trigger Event.
32. A Non-Viability Trigger Event occurs when APRA notifies Warwick in writing that it believes:
- conversion of all or some of the Notes is necessary, because without it, Warwick would become non-viable, or

- a public sector injection of capital, or equivalent support, is necessary because, without it, Warwick would become non-viable.

33. If a Non-Viability Trigger Event occurs, Warwick must Convert all or some of the Notes to MEIs or Write-Off all or some Perpetual Subordinated Instruments (which includes the Notes).

34. Conversion of the relevant Notes will be taken to have occurred immediately on the Trigger Event Conversion Date.

35. If, for any reason, Conversion of any of the Notes fails to take effect and Warwick is not otherwise able to issue the MEIs required to be issued in respect of such Conversion within five Business Days of the Trigger Event Conversion Date, the Notes will be written off and the relevant Holders' rights (including to Distributions and the Face Value and any other payments) in relation to such Notes are immediately and irrevocably terminated and such termination will be taken to have occurred immediately on the Trigger Event Conversion Date.

#### **MEIs obtained on Conversion**

36. A Conversion of the Notes into MEIs is achieved through:

- the compulsory termination of the Notes in consideration for a payment equal to the Face Value of each Note, and
- the application of that payment to subscribe for the issue of new MEIs to the Holder.

37. MEIs are a form of interest qualifying as Common Equity Tier 1 Capital under the Prudential Standard APS 111 that are able to be issued by a mutually owned credit union regulated as an ADI upon conversion of the Notes. Warwick has obtained APRA approval for the issuance of the Notes that may convert into MEIs.

38. The MEIs into which the Notes may convert are perpetual interests in the capital of Warwick that on the event of a winding-up or liquidation rank equally with the other members' interests in the capital of Warwick forming part of Warwick's Common Equity Tier 1 capital, and constitute the most subordinated claim in the event of a winding up of Warwick.

39. Payments of distributions on the MEIs constitute dividends, and are within the absolute discretion of Warwick and non-cumulative. Distributions are only payable in cash. If a distribution is not paid because the relevant conditions are not satisfied or because of any other reason, Warwick has no liability to pay such distributions to the Holder and the Holder has no claim or right to apply for winding up in respect of such non-payment. Non-payment of a distribution does not constitute an event of default.

40. Where Warwick elects to make a distribution on MEIs, the distribution is calculated as being the proportion of all MEIs in Warwick held by the relevant holder multiplied by the income of Warwick for the relevant period determined according to ordinary concepts that is available for distribution after payment of, or provision for, costs, expenses and outgoings in accordance with normal concepts.

## Redemption

41. Warwick may at its option Redeem:

- all or some of the Notes on 15 December 2022 or on an Optional Redemption Date, or
- all (but not some) of the Notes on a Redemption Date following the occurrence of a Tax Event or Regulatory Event.

42. Warwick will Redeem each Note for cash equal to their Face Value.

43. Redemption requires the prior written approval of APRA. Approval is at the discretion of APRA and may or may not be given.

44. Upon payment of the Redemption Price, all other rights conferred, or restrictions imposed, by the Note will no longer have effect.

45. An Optional Redemption Date is also a Distribution Payment Date which means Holders will receive any Distribution entitlements up to and including the Optional Redemption Date (subject to the Distribution Payment Conditions described in paragraph 28). Redemption may occur even if Warwick, in its absolute discretion, does not pay a Distribution for the final Distribution Period.

46. Holders do not have a right to request Redemption of their Notes at any time.

## Other matters and assumptions

47. The Ruling is made on the basis that:

- (a) The documents listed in paragraph 12 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, Warwick will be a resident of Australia under the income tax laws of Australia and will not be a resident of any other jurisdiction.
- (c) The Distributions on the Notes will not be sourced directly or indirectly from Warwick's share capital

- account or non-share capital account, or be debited against Warwick's share capital account or non-share capital account.
- (d) Distributions on the Notes will be frankable distributions pursuant to section 202-40 of the ITAA 1997 as the Distributions are not unfrankable pursuant to section 202-45 of the ITAA 1997.
  - (e) Warwick will not differentially frank Distributions to different Holders in respect of the Notes according to the tax status of Holders or on any other basis.
  - (f) Warwick expects to fully frank all frankable distributions for the foreseeable future.
  - (g) Warwick will frank Distributions in respect of the Notes at the benchmark franking percentage for the franking period in which the payments are made.
  - (h) Warwick expects that future tax payments will generate sufficient franking credits for Warwick to continue its current policy to fully frank the Distributions.
  - (i) Immediately before the payment of a franked Distribution on the Notes, Warwick will have sufficient available frankable profits for the purposes of section 215-20 of the ITAA 1997.
  - (j) A Holder or an associate of a Holder has not made, is not under an obligation to make, and 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 on the Notes.
  - (k) For the purposes of determining whether a Holder is a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, neither a Holder nor an associate of a Holder will take any position (apart from holding the Notes) in relation to their Notes.
  - (l) The Holders in receipt of Distributions on the Notes will hold their Notes for a period of at least 90 days (excluding the day of acquisition and disposal) beginning on the day after the acquisition of the Notes.
  - (m) The Holders or their connected entities will not engage in distribution washing (within the meaning of section 207-157 of the ITAA 1997) in relation to Distributions on the Notes (unless entitled to the exception under subsection 207-157(4) of the ITAA 1997).
  - (n) Warwick does not have a permanent establishment or carry on any business outside of Australia and the Notes will be issued by Warwick in Australia.

- (o) All parties to the scheme are dealing with each other on arm's length terms and fair value consideration will be provided by the Holders to acquire the Notes.
- (p) The majority of the Holders of the Notes are expected to be Australian residents for tax purposes, although some may be non-residents.
- (q) On a Conversion, Warwick will debit the Face Value of the Notes to its non-share capital account.
- (r) On a Redemption, Warwick will make redemption payments out of capital, and not out of profits.

## **Ruling**

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### **Notes are non-share equity interests**

48. The Notes are an equity interest under item 4 of the table in subsection 974-75(1) of the ITAA 1997.

49. As the Notes are equity interests that are not solely shares, they are non-share equity interests under subsection 995-1(1) of the ITAA 1997.

### **Notes will not be traditional securities**

50. The Notes are not a traditional security under subsection 26BB(1) of the ITAA 1936.

### **Notes will not be qualifying securities**

51. The Notes will not be qualifying securities under subsection 159GP(1) of the ITAA 1936.

### **MEIs are shares**

52. MEIs will constitute shares under subsection 995-1(1) of the ITAA 1997.

### **Acquisition of the Notes – CGT implications**

#### ***Acquisition time of the Notes***

53. Under item 2 of the table in section 109-10 of the ITAA 1997, a Holder will acquire a Note on 15 December 2017 being the date the contract for the issue of a Note is entered into.

***Cost base and reduced cost base of each Note***

54. 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 Warwick (subsections 110-25(2) and 110-55(2) of the ITAA 1997).

***Conversion of the Notes – CGT implications***

55. CGT event C2 (section 104-25 of the ITAA 1997) will happen for Holders on Conversion of the Notes into MEIs.

56. Any capital gain or capital loss made by a Holder from CGT event C2 happening on Conversion of Notes will be disregarded (subsection 130-60(3) of the ITAA 1997).

***Cost base and reduced cost base of each MEI acquired on conversion***

57. 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 MEI acquired from Conversion will be equal to the cost base and reduced cost base of each Note at the time of Conversion (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

***Acquisition time of the MEIs acquired on conversion***

58. MEIs acquired by the Holders on Conversion of the Notes will be taken to have been acquired when the Conversion happens on the relevant Trigger Event Conversion Date (subsection 130-60(2) of the ITAA 1997).

***Allotment of MEIs on Conversion neither a dividend nor a non-share dividend***

59. The issue of MEIs to Holders of Notes on Conversion will not result in Holders being taken to have received a dividend as defined in subsection 6(1) of the ITAA 1936.

60. The issue of MEIs to Holders of Notes on Conversion will not result in Holders being taken to have received a non-share dividend under subsection 974-120(2) of the ITAA 1936.

61. Accordingly, the issue of MEIs to Holders of Notes on Conversion should not be included in the Holders assessable income under subparagraph 44(1)(a)(i) or 44(1)(a)(ii) of the ITAA 1936.

## **Section 45 of the ITAA 1936**

62. Section 45 of the ITAA 1936 will not apply to treat the value of the MEIs issued to the Holders on Conversion as an unfrankable dividend paid by Warwick.

## **Section 45A of the ITAA 1936**

63. 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 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**

64. 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 capital benefit that arises on Conversion or Redemption of the Notes as an unfranked dividend in the hands of Holders.

## **Inclusion of Distributions and franking credits in assessable income**

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

66. Holders must 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 for franking credits**

67. Holders 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 and none of the exceptions in Subdivision 207-E of the ITAA 1997 apply.

***Exempt income or non-assessable non-exempt income***

68. If the Distribution (or 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 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) unless any of the exceptions in Subdivision 207-E of the ITAA 1997 apply.

***Franking credit subject to the refundable tax offset rules***

69. 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***

70. 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 paid in respect of the Notes.

***Dividend stripping operation***

71. Distributions on the Notes will not be made as part of a dividend stripping operation for the purposes of paragraph 207-145(1)(d) and section 207-155 of the ITAA 1997.

***Section 177EA of the ITAA 1936***

72. 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**

73. 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 of the ITAA 1997 will not adjust the gross-up of the Holders' assessable income to exclude the franking credit, nor will it deny the tax offset to which the Holders would have otherwise been entitled.

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**Commissioner of Taxation**

20 December 2017

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## Appendix 1 – Explanation

**①** *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.*

### **Notes are non-share equity interests**

74. A non-share equity interest is defined under section 995-1(1) of the ITAA 1997 to mean an equity interest in the company that is not solely a share.

75. Paragraph (b) of item 4 of the table in subsection 974-75(1) of the ITAA 1997 provides that an interest is an equity interest if it is an interest issued by the company that is an interest that will, or may, convert into an equity interest in the company.

76. Each Note may be converted into an MEI if a Non-Viability Trigger Event occurs. MEIs are an equity interest within the meaning of item 1 of the table in subsection 974-75(1) of the ITAA 1997. Therefore, the Notes are equity interests under paragraph (b) of item 4 of the table in subsection 974-75(1) of the ITAA 1997.

77. For the Notes to be an equity interest, they must also constitute a financing arrangement as defined under 974-130(1) of the ITAA 1997. Each Note is a financing arrangement for Warwick as it enables Warwick to raise finance.

78. The Notes can only be an equity interest if they are not a debt interest. An important requirement of a debt interest is that the entity that issues the debt instruments will have an effectively non-contingent obligation (ENCO) to provide benefits under the scheme (paragraph 974-20(1)(d) of the ITAA 1997). The Notes will not satisfy the ENCO requirement because:

- the Note Terms do not provide for an ENCO to repay the Face Value as the repayment of the Face Value can only occur at the discretion of Warwick and with the prior approval of APRA, and
- the Note Terms do not provide for an ENCO to pay any Distributions as the payment of Distributions is at the absolute discretion of Warwick and is non-cumulative. Furthermore, if a Distribution is not paid, Warwick has no liability to pay the unpaid amount of the Distribution; Holders have no claim or entitlement in respect of non-payment; and, such non-payment does not constitute an event of default.

79. As the Notes will not satisfy the ENCO requirement, the Notes do not constitute debt interests in Warwick and section 974-70(1) of the ITAA 1997 will not prevent the Notes from being characterised as an equity interest in Warwick.

80. As the Notes are an equity interest that is not solely a share, they are a non-share equity interest within the meaning of section 995-1(1) of the ITAA 1997.

## Notes will not be traditional securities

81. 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 trading stock of the taxpayer, and
- either does not have an eligible return, or has an eligible return that satisfies the conditions listed in the definition of traditional security in subparagraph 26BB(1)(b)(ii) of the ITAA 1936.

82. 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) of the ITAA 1936, 'security' means:

- stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security (paragraph 159GP(1)(a) of the ITAA 1936);
- a deposit with a bank or other financial institution (paragraph 159GP(1)(b) of the ITAA 1936);
- a secured or unsecured loan (paragraph 159GP(1)(c) of the ITAA 1936); or
- 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 (paragraph 159GP(1)(d) of the ITAA 1936).

83. Paragraph 159GP(1)(a) of the ITAA 1936 will not apply because a Note is not stock, a bond, debenture, certificate of entitlement, bill of exchange, or a promissory note.

84. The term 'other security' in paragraph 159GP(1)(a) of the ITAA 1936 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 159GP(1)(a) of the definition of security will generally be recognised as debt instruments (Taxation Ruling TR 96/14 *Income tax: traditional securities*). The Note Terms do not evidence an obligation on the part of Warwick to pay an amount to the Holder as any payments are at the absolute discretion of Warwick.

85. Paragraphs 159GP(1)(b) and 159GP(1)(c) of the ITAA 1936 do not apply because the Note is neither a deposit with a bank or other financial institution, nor a secured or unsecured loan.

86. Paragraph 159GP(1)(d) of the ITAA 1936 will only apply to those contracts that have debt like obligations (TR 96/14).

87. The Note Terms do not evidence a liability by Warwick to pay an amount or amounts to Holders of the Notes during the term of the instrument or at maturity.

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

89. The payment by Warwick of Distributions is subject to certain conditions. Distributions are paid at the discretion of Warwick and are non-cumulative. If a Distribution is not paid, Warwick has no liability to pay the Distribution; Holders have no claim in respect of such non-payment; and, such non-payment does not constitute an event of default.

90. Furthermore, the Note Terms provide for the Conversion of the Notes in return for Warwick allotting and issuing the Conversion number of MEIs based on the Face Value of the Notes and a formula set out in the Note Terms for each Note held by the Holders. Warwick does not have to Convert the Notes if it is unable to for any reason. In that case, the Notes will be Written-Off. Warwick cannot be said to have a liability to pay an amount under the Note Terms pursuant to the Conversion.

91. Redemption of a Note is possible. However it is at the discretion of Warwick on an Optional Redemption Date; or, upon the occurrence of certain events, at the discretion of Warwick, and in both cases requires the prior written approval of APRA. Warwick cannot be said to have a liability to pay an amount under the Note Terms.

92. Warwick will not become liable to pay an amount in respect of a Note upon winding up as it would be expected that, before winding up commences, the Note would either be converted into an MEI pursuant to a Non-Viability Trigger Event (in which case any distribution would be made to the Holders as shareholders as opposed to under the Note Terms), or Holders' rights would be terminated where Warwick is not able to allot and issue an MEI within the time required by the Note Terms.

93. For the reasons above, the Note Terms do not establish any liability on Warwick to pay an amount that exhibits the debt like obligation as contemplated by paragraph 159GP(1)(d) of the ITAA 1936.

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

### **Notes will not be qualifying securities**

95. Subsection 159GP(1) of the ITAA 1936 defines a 'qualifying security' as a 'security' of a certain kind.

96. As the Notes are not a 'security' within the meaning of the definition of 'security' in subsection 159GP(1) of the ITAA 1936, the Notes are not a 'qualifying security' within the meaning of section 159GP(1) of the ITAA 1936.

## **MEIs are shares**

97. The term 'share' is defined in subsection 995-1(1) of the ITAA 1997 as a share in the capital of the company and includes stock. Under subsection 6(1) of the ITAA 1936, the term 'share' has the same meaning as subsection 995-1(1) of the ITAA 1997.

98. An MEI in Warwick will consist of an interest in the capital of Warwick that provides its Holder the right to participate in dividends whilst the company is a going concern and a right to a proportionate distribution of Warwick's surplus assets available for members of the company upon winding up. Furthermore, an MEI is a chose in action which entitles the Holder to the rights and subjects them to the liabilities as provided for by Warwick's Constitution and by the *Corporations Act 2001*.

99. Therefore, MEIs constitute 'shares' as defined in subsection 995-1(1) of the ITAA 1997.

## **Acquisition of the Notes – CGT implications**

### ***Acquisition time of the Notes***

100. 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).

101. The Notes are equity interests in Warwick for the purposes of Division 974 of the ITAA 1997. When an investor's application for the Notes is accepted by Warwick, this leads to the formation of a contract for the issue of the 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 15 December 2017, being the date on which the contract for the issue of the Notes is entered into.

### ***Cost base and reduced cost base of each Note***

102. 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).

103. 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 Note is \$100.

## **Conversion of the Notes – CGT implications**

104. 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.

105. The Notes are convertible interests for the purposes of subsection 995-1(1) of the ITAA 1997 as they are an equity interest under item 4 of the table in section 974-75(1) of the ITAA 1997. Conversion of the Notes for MEIs constitutes the conversion of a convertible interest.

106. Conversion of the Notes happens as part of a conversion to which Subdivision 130-C of the ITAA 1997 applies because Holders will acquire shares (MEIs) on Conversion of the Notes. Under subsection 130-60(3) of the ITAA 1997, a capital gain or capital loss made from converting a convertible interest is disregarded. As such, any capital gain or capital loss made by a Holder from CGT event C2 happening on Conversion of the Notes will be disregarded.

***Cost base and reduced cost base of each MEI acquired on conversion***

107. 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 MEI acquired from the Conversion of the Notes will be a pro-rata portion of the cost base and reduced cost base of each Note at the time of Conversion (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

***Acquisition time of the MEIs acquired on conversion***

108. MEIs acquired on Conversion of the Notes (being convertible interests) will be taken to be acquired when the Conversion happens on the relevant Trigger Event Conversion Date (subsection 130-60(2) of the ITAA 1997).

***Allotment of MEIs on Conversion neither a dividend nor a non-share dividend***

109. Under subparagraph 44(1)(a)(i) of the ITAA 1936 the assessable income of a shareholder, who is a resident, includes 'dividends (other than non-share dividends)' that they receive.

110. The issue of MEIs to Holders on Conversion is a distribution of property to Holders. As the MEIs will not be issued to the Holders of the Notes as shareholders of Warwick, but by virtue of the Holders' rights as holders of the Notes, the issue of MEIs to Holders of Notes on Conversion will not constitute a dividend under subsection 6(1) of the ITAA 1936. Accordingly, the issue of MEIs on Conversion will not be included in assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

111. The issue of MEIs to Holders on Conversion is a distribution of property to holders of a non-share equity interest and, accordingly, is a non-share distribution under subparagraph 974-115(b)(ii) of the ITAA 1997. Under subsection 974-120 of the ITAA 1997, a non-share distribution is a non-share dividend, except to the extent to which the company debits the distribution against the company's share capital account or non-share capital account.

112. On Conversion, Warwick will debit the Face Value of the Notes to its non-share capital account. Accordingly, the issue of MEIs on Conversion is not a non-share dividend and will not be included in assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

## **Section 45 of the ITAA 1936**

113. 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%.

114. The Conversion of the Notes will not involve the streaming of MEIs and minimally franked Distributions. This is because Conversion simply involves the compulsory termination of some or all of the Notes and the application of the proceeds to acquire MEIs. Conversion does not involve the payment of Distributions.

115. Further, Warwick expects to fully frank all frankable distributions for the foreseeable future, and expects that future tax payments will generate sufficient franking credits for Warwick to continue its current policy of fully franking.

116. 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 MEIs issued on Conversion, as an unfrankable dividend in the hands of Holders.

## **Section 45A of the ITAA 1936**

117. 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).

118. The Commissioner may make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

119. A provision of capital benefits includes the provision to the equity holders of non-share equity interests in the company pursuant to paragraph 45A(3)(a) of the ITAA 1936. The issue of MEIs to Holders on Conversion of the Notes will constitute the provision of capital benefits.

120. The issue of MEIs on Conversion of the Notes is in effect a restatement of the Holder's interest in the capital of Warwick. In the absence of any other factors that would contribute to an alternative conclusion, there will not be any streaming of capital benefits.

121. The Redemption of the Notes will involve the provision of a capital benefit within the meaning of subsection 45A(3)(b) 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 a date of Redemption occurs is also a Distribution Payment Date under the Note Terms.

122. Accordingly, it cannot be said that Holders would derive a greater benefit from capital benefits than other Warwick shareholders. Therefore, the Redemption or the issue of MEIs on Conversion of the Notes will not trigger the application of section 45A of the ITAA 1936.

### **Section 45B of the ITAA 1936**

123. 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.

124. Where section 45B of the ITAA 1936 applies to a scheme or transaction, the Commissioner may make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

125. The issue of MEIs to Holders on Conversion will constitute a scheme under which the Holders are provided with a capital benefit by Warwick (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 Warwick (paragraph 45B(5)(b) of the ITAA 1936 and subsection 45B(7) of the ITAA 1936).

126. 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.

127. Having regard to the relevant circumstances surrounding the issue of the Notes, it cannot be concluded that Warwick, the Holders or any other person entered into or carried out the issue of the Notes for the purpose, other than an incidental purpose of enabling Holders to obtain a tax benefit.

128. Similarly, it cannot be said that Conversion or Redemption will involve any benefit provided to Holders that is in substitution for Distributions. The amount paid to Holders on Redemption is limited to an amount equal to the Face Value of the Notes and any Distribution entitlements on the Notes will be separately paid as a Distribution given that the date of Redemption will also be a Distribution Payment Date under the Note Terms.

129. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936.

## **Inclusion of Distributions and franking credits in assessable income**

130. 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.

131. The Notes are non-share equity interests within the meaning of subsection 995-1(1) of the ITAA 1997. Distributions paid in respect of non-share equity interests are non-share distributions pursuant to section 974-115 of the ITAA 1997. Section 974-120 of the ITAA 1997 provides that all non-share distributions are non-share dividends unless a non-share dividend is debited against the company's non-share capital account or share capital account.

132. Distributions will not be debited against Warwick's non-share capital account or share capital account. Therefore, Distributions paid in respect of the Notes are non-share dividends under section 974-120 of the ITAA 1997. Accordingly, Holders must include in their assessable income Distributions paid in respect of the Notes under subparagraph 44(1)(a)(ii) of the ITAA 1936.

133. Distributions 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 receiving entity include the amount of the franking credit on the distribution in addition to the amount of the franked distribution. Subsection 207-20(2) of the ITAA 1997 provides that the receiving entity is entitled to a tax offset equal to the franking credit on the distribution.

134. In accordance with subsection 207-20(1) of the ITAA 1997, any franking credit attached to a Distribution must also be included in the relevant Holder's assessable income for the income year in which the Distribution is made.

**Entitlement to a tax offset for franking credits**

135. In accordance with subsection 207-20(2) of the ITAA 1997, Holders are entitled to receive a tax offset equal to the franking credit on a Distribution they receive, unless 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.

***Exempt income or non-assessable non-exempt income***

136. Subdivision 207-D of the ITAA 1997 provides that if a Distribution (or 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.

137. However, Subdivision 207-E of the ITAA 1997 provides a number of exceptions to the rules in Subdivision 207-D of the ITAA 1997 for certain exempt institutions, trusts and life insurance companies.

***Franking credit subject to the refundable tax offset rules***

138. Division 67 of the ITAA 1997 contains the refundable tax offset rules, and, in particular, sets out which tax offsets can be refunded if they exceed basic income tax liability.

139. Subsection 67-25(1) of the ITAA 1997 provides that tax offsets available under Division 207 of the ITAA 1997 are subject to the refundable tax offset rules, unless otherwise excluded.

140. 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.

141. 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.

142. 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 they satisfy the requisite conditions as set out in subsections 67-25(1C) or 67-25(1D) of the ITAA 1997.

## **Imputation benefits – streaming of imputation benefits**

143. Subsection 204-30(1) of the ITAA 1997 empowers the Commissioner to make a determination under paragraph 204-30(3)(c) of the ITAA 1997 in cases where streaming of distributions is identified.

144. The term 'streaming' is not defined in the ITAA 1997.

145. At paragraphs 3.28 and 3.29 of the Explanatory Memorandum to the *New Business Tax System (Imputation) Bill 2002 (Cth)*, which introduced Subdivision 204-D to the ITAA 1997, it is explained that:

3.28 Streaming is selectively directing the flow of franked distributions to those members who can most benefit from imputation credits.

3.29 The law uses an essentially objective test for streaming, although purpose may be relevant where future conduct is a relevant consideration. It will normally be apparent on the face of an arrangement that a strategy for streaming is being implemented. The distinguishing of members on the basis of their ability to use franking benefits is a key element of streaming.

146. As such, 'streaming' involves the distribution of franking credits in a way which provides an enhanced benefit to a certain category of members based upon their respective tax attributes.

147. The Notes will be available for investment by different types of investors. All Holders of the Notes will receive Distributions which are franked to the same percentage regardless of their tax attributes or their individual tax position. Warwick's policy in relation to the franking of its frankable distributions is not expected to change as a result of the issue of the Notes.

148. Further, the MEIs allotted on Conversion of the Notes will not constitute a 'distribution' as defined in section 960-120 of the ITAA 1997 for the purposes of section 204-30 of the ITAA 1997, as the issue of MEIs on a Conversion represents a substitution of one form of equity interest in the company with another and is not a dividend and should not be taken to be a dividend for tax purposes. The allotment of MEIs will not affect Warwick's dividend franking policy.

149. 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 Warwick to 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 received by a Holder in relation to Distributions paid in respect of the Notes.

## **Section 177EA of the ITAA 1936**

150. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies where one of the purposes (other than an incidental purpose) of the scheme is to obtain an imputation benefit.

In these circumstances, subsection 177EA(5) of the ITAA 1936 enables the Commissioner to make a determination with the effect of either:

- imposing franking debits or exempting debits on the distributing entity's franking account, or
- denying the imputation benefit on the distribution that flowed directly or indirectly to the relevant taxpayer.

151. Pursuant to subsection 177EA(3) of the ITAA 1936, the provision applies if the following conditions are satisfied:

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

152. Subsection 177EA(12) of the ITAA 1936 extends the operation of section 177EA of the ITAA 1936 to non-share equity interests.

153. The Commissioner considers that the conditions in paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied because:

- (a) the issue of the Notes constitutes a scheme for the disposition of a membership interest (paragraph 177EA(3)(a) of the ITAA 1936).

Pursuant to paragraph 177EA(14)(a) of the ITAA 1936, there will be a 'scheme for a disposition of membership interests' if there is a scheme that involves the issuing of membership interests. Paragraph 177EA(12)(a) of the ITAA 1936 applies to treat non-share equity interests in the same way as 'membership interests' under section 177EA. Therefore, as the Notes are non-share equity interests, paragraph 177EA(3)(a) of the ITAA 1936 is satisfied

- (b) frankable distributions are expected to be payable to the Holders (paragraph 177EA(3)(b) of the ITAA 1936). The Commissioner accepts that Distributions payable on the Notes will be frankable distributions and not 'unfrankable' under section 202-45 of the ITAA 1997
- (c) franked distributions are expected to be paid to the Holders (paragraph 177EA(3)(c) of the ITAA 1936). It is expected that these distributions will be made on a quarterly basis. Furthermore, Warwick has advised that it will continue its policy of fully franking all frankable distributions made by it, to the extent that franking credits are available in its franking account, and
- (d) It is reasonable to expect that an imputation benefit will be received by the relevant taxpayers as a result of Distributions made to Holders, given that Warwick expects to frank the Distributions on the Notes (paragraph 177EA(3)(d) of ITAA 1936).

154. 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, did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer (Holders of the Notes) to obtain an imputation benefit (paragraph 177EA(3)(e) of the ITAA 1936).

155. Circumstances which are relevant in determining whether any person has the requisite purpose include, but are not limited to, the factors listed in subsection 177EA(17) of the ITAA 1936.

156. The relevant circumstances listed 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 or may not be present at any one time in relation to a particular scheme.

157. Based on the information provided and the qualifications set out in this Ruling, and having regard to all the relevant circumstances of the scheme, the Commissioner has concluded that the purpose of enabling the Holders to obtain imputation benefits is no more than incidental to Warwick's purpose of raising Tier 1 Capital to meet its capital adequacy requirements.

158. 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 received by Holders in relation to Distributions paid in respect of the Notes.

### **Gross-up and tax offset denied in certain circumstances**

159. 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.

160. Section 207-145 of the ITAA 1997 provides the circumstances that must exist before this adjustment can occur. Pursuant to subsection 207-145(1) of the ITAA 1997, a 'manipulation of the imputation system' may 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), or
- the distribution is one to which section 207-157 of the ITAA 1997 (which is about distribution washing) applies (paragraph 207-145(da) of the ITAA 1997).

161. 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).

162. 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.

163. 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 the shares (or non-share equity interests) to have been continuously held at risk throughout the primary qualification period (former paragraph 160APHO(1)(a) of the ITAA 1936).

164. 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 the shares (or non-share equity interests) to have been continuously held at risk throughout the secondary qualification period (former paragraph 160APHO(1)(b) and former section 160APHN of the ITAA 1936).

165. The Notes are non-share equity interests that carry non-cumulative non-share dividend entitlements. Should a Distribution in respect of the Notes not be paid as scheduled, Warwick is not entitled to pay dividends on MEI (that is, the Distribution is in preference to MEI) unless Special Resolution is passed (broadly, a resolution passed by at least 75% of the Holders). Additionally, the Notes are ranked ahead of the MEIs upon a winding up. The Notes are therefore less risky than MEIs in Warwick and will be considered 'preference shares', as defined in former section 160APHD of the ITAA 1936.

166. A Holder of a Note 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 90th 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 are 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).

167. In determining whether a shareholder is a 'qualified person' in relation to dividends paid on their shares, all 'positions' in respect of the shares 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.

168. Based on the information provided and the qualifications set out in this Ruling, the Commissioner has concluded that the Holders will be qualified persons. Therefore paragraph 207-145(1)(a) of the ITAA 1997 will not apply.

169. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) of the ITAA 1997 to deny the imputation benefits attached to Distributions paid to Holders in respect of the Notes.

170. A distribution will be taken to be made as part of a dividend stripping operation, pursuant to paragraph 207-145(1)(d) 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.

171. The Replacement Offer Information Statement and the Note Terms provide 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.

172. Neither the Holders nor their connected entities will engage in distribution washing (within the meaning of section 207-157 of the ITAA 1997) in relation to Distributions on the Notes (unless entitled to the exception under subsection 207-157(4) of the ITAA 1997).

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

## **Appendix 2 – Detailed contents list**

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Not previously issued as a draft

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TR 96/14; TR 2006/10

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