

IT 2411 - Income tax : convertible notes - meaning of convertible note - perpetual floating rate note

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TAXATION RULING NO. IT 2411

INCOME TAX : CONVERTIBLE NOTES - MEANING OF CONVERTIBLE
NOTE - PERPETUAL FLOATING RATE NOTE

F.O.I. EMBARGO: May be released

REF

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1218575	CONVERTIBLE NOTES	51 82L DIV 3A

PREAMBLE

This Office has considered whether the provisions of Division 3A, Part III of the Income Tax Assessment Act, which set out the circumstances in which interest payable on convertible notes is allowable as an income tax deduction, apply to financing arrangements involving the issue of perpetual floating rate notes by banks.

FACTS

2. A perpetual floating rate note is a long term security carrying a rate of interest which is usually at a margin above a benchmark rate, i.e. the rate paid for similar deposits of US dollars in the London inter-bank market (LIBOR). The rate of interest attaching to the notes is set periodically. The notes are perpetual in the sense that they are undated and have no final maturity date on which an investor can present the note to the issuer for repayment of the principal. The investor is compensated for this by the payment of the above-average rate of interest.

3. Conditions set by the Reserve Bank provide for the rights of the holders of perpetual floating rate notes to be subordinated to the claims of other creditors and depositors. If, during an interest period no dividend or other distribution is declared, paid or made on any class of its share capital, the issuing bank is not obliged to pay interest on the notes. Any interest not paid by the issuing bank ceases to be payable and noteholders do not have any right to the unpaid interest. Before any notes may be repaid the consent of the Reserve Bank of Australia must be obtained. No right or option is conferred upon the noteholder to have the loan to the issuing bank converted into shares in the company or another company nor is the noteholder entitled to a right or option to acquire shares in the company or another company.

4. A convertible note, as defined in sub-section 82L(1) of Division 3A, Part III, includes a note issued by a company that provides:

- (a) that the amount of the loan to the company may, directly or indirectly, be converted into, or redeemed by, the issue of shares in a company; or
- (b) that a person is entitled to a right or option to acquire shares in a company.

Because perpetual floating rate notes do not confer on noteholders a right or option to have the loan converted into shares and the noteholder is not entitled to a right or option to acquire shares in the company or another company the notes do not constitute convertible notes within the meaning of sub-section 82L(1). The provisions of Division 3A of Part III do not apply to the note. Where the proceeds from the issue of the notes are to be used in the conduct of the business of an issuing bank, interest payable on notes may be allowed as an income tax deduction under sub-section 51(1) of the Act.

COMMISSIONER OF TAXATION
18 June 1987