



Class Ruling

Income tax: Commonwealth Bank of Australia – Perpetual Exchangeable Resaleable Listed Securities

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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.

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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 ITAA 1936;
- Subsection 6(4) of the 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 1A of former Part IIIAA of the ITAA 1936;
- Division 67 of the ITAA 1997;
- Division 104 of the 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 118-20 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 974-75 of the ITAA 1997;
- Section 974-165 of the ITAA 1997; and
- Section 995-1 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are investors (referred to as Holders) who acquired perpetual, exchangeable, resaleable, listed, subordinated, unsecured notes (called PERLS VI) issued by the Commonwealth Bank of Australia (CBA) and who:

- are residents of Australia (within the meaning of subsection 6(1) of the ITAA 1936);
- hold their PERLS VI 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 of the ITAA 1997 will generally not apply to individuals unless they have made an election for it to apply to them).

4. The class of entities to which this Ruling applies does not extend to Holders of PERLS VI who acquired their PERLS VI otherwise than by initial application under the Prospectus.

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

6. This Ruling does not consider the tax implications of an Early Exchange or Resale of PERLS VI.

7. This Ruling does not consider how the taxation law applies to a Purchaser who acquires PERLS VI under a Resale Notice.

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

9. This Ruling does not deal with how the taxation law applies to CBA in relation to the issue of PERLS VI.

Qualifications

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

11. 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 15 to 46 of this Ruling.

12. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

14. This Ruling applies from 1 July 2012 to 30 June 2021. The Ruling continues to apply after 30 June 2021 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 the Taxation Ruling TR 2006/10).

Scheme

15. The following description of the scheme is based on information provided by Greenwoods & Freehills Pty Limited on behalf of CBA as the Applicant. The following documents, or relevant parts of them, form part of and are to be read with the description:

- the application for Class Ruling dated 12 September 2012 and Appendices;
- the Prospectus and PERLS IV Reinvestment Offer Information PERLS VI Perpetual Exchangeable Resaleable Listed Securities dated 12 September 2012 that replaced the Prospectus dated and lodged with ASIC on 3 September 2012. (Prospectus);
- the Terms of PERLS VI (Terms);
- the PERLS VI Trust Deed;
- further correspondence provided by CBA.

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

16. In this Ruling, unless otherwise defined, capitalised terms take their meaning as specified in the Terms attached as Appendix A to the Prospectus.

17. CBA is an authorised deposit-taking institution (ADI) regulated by the Australian Prudential Regulation Authority (APRA) and other regulatory bodies.

18. In the Prospectus, CBA announced its intention to undertake a capital raising by the issue of PERLS VI at a face value of \$100 each to raise \$1.5 billion, with the ability to raise more or less.

19. On 17 October 2012 CBA allotted 20 million PERLS VI, which raised \$2 billion.

20. PERLS VI are perpetual, exchangeable, resaleable, listed, subordinated, unsecured notes issued by CBA. Holders acquired PERLS VI for an issue price (Face Value) of \$100 each on the Issue Date of 17 October 2012 pursuant to the terms of the Offer in the Prospectus.

21. PERLS VI are listed on the Australian Securities Exchange (ASX) and trade under ASX Code CBAPC. When an Exchange occurs, PERLS VI will be terminated and Exchanged for Ordinary Shares in CBA.

22. APRA has confirmed that PERLS VI will be treated as Innovative Tier 1 Capital under APRA's current prudential standard APS 111 and as Additional Tier 1 Capital under the Basel III capital adequacy framework to be implemented from 1 January 2013.

Main features of PERLS VI

23. PERLS VI are fully paid, perpetual, exchangeable, resaleable, listed, subordinated, unsecured, notes issued by CBA.
24. The issue price of each PERLS VI (Face Value) is \$100. PERLS VI are fully paid up to \$100 of Face Value.
25. PERLS VI generally do not have voting rights, except in the limited circumstances described in clause 12.2 of the Terms.
26. Holders of PERLS VI do not have a right to require redemption of PERLS VI.

Distribution calculation

27. Subject to the conditions outlined at paragraph 30 of this Ruling, the holder of each PERLS VI is entitled to receive on the relevant Distribution Payment Date, a Distribution payable in arrears calculated in the following manner:

$$\text{Distribution} = \text{Face Value} \times \text{Distribution Rate}$$

The Distribution Rate is a floating rate and is determined quarterly as the sum of the Market Rate and the Margin, multiplied by (1- Tax Rate):

Where:

Market Rate means the rate (expressed as a percentage per annum) which is the average mid-rate for Bills for a term of 90 days as displayed on the 'BBSW' page of the Reuters Monitor System (or any page that replaces that page) on the first Business Day of the Distribution Period. However, if the average mid-rate is not displayed by 10:30am on that day, or if it is displayed but CBA determines that there is a manifest error in that rate, Market Rate means the rate specified by CBA in good faith at or around 10:20am on that day, having regard, to the extent possible, to:

- (a) the rates otherwise bid and offered for Bills of a term of 90 days at or around that time on that day (including any displayed on the 'BBSW' page of the Reuters Monitor System (or its successor or replacement page); and
- (b) if bid and offer rates for Bills of a term of 90 days are not otherwise available, the rates otherwise bid and offered for funds of a term of 90 days at or around that time on that day;

Bill has the meaning it has in the *Bills of Exchange Act 1909*;

Margin is 3.80% per annum; and

Tax Rate means the Australian corporate tax rate on the relevant Distribution Payment Date (expressed as a decimal).

28. Distributions are expected to be fully franked. However, if any Distribution is not franked or only partially franked, the Distribution will be grossed-up to the extent that the franking percentage of the Distribution is less than 100%.

29. Distributions are scheduled to be paid quarterly in arrears on the Distribution Payment Dates of 15 March, 15 June, 15 September and 15 December until the PERLS VI has been Exchanged or Redeemed. If any of these scheduled dates is not a Business Day, then the payment will be made on the next Business Day.

Distribution Payment Conditions

30. The payment of any Distribution on any Distribution Payment Date is subject to:

- CBA, in its absolute discretion, making the Distribution to Holders;
- unless APRA otherwise agrees in writing, CBA having sufficient Distributable Profits available to pay the distribution. (CBA expects that APRA will not withhold its approval);
- the payment of the Distribution not resulting in a breach of CBA's capital adequacy requirements under APRA's prudential standards as they apply at the time of the payment;
- the payment of the Distribution not resulting in CBA becoming, or being likely to become, insolvent; and
- APRA not otherwise objecting to the payment of the Distribution.

31. Distributions are discretionary and non-cumulative and no interest accrues on any unpaid Distribution. If a Distribution is not paid in full because the relevant conditions are not satisfied or because of any other reason, CBA has no liability to pay that Distribution and Holders have no claim in respect of non-payment.

32. Subject to certain exceptions, non-payment of a Distribution will restrict CBA from declaring or paying a dividend or distribution on Ordinary Shares or returning any capital or undertaking any buy-backs or repurchases in relation to Ordinary Shares.

Mandatory Exchange

33. Each PERLS VI will mandatorily Exchange into Ordinary Shares on the date that is the earlier of (each a Mandatory Exchange Date):

- 15 December 2020 (Scheduled Mandatory Exchange Date); and
- the first Distribution Payment Date after the Scheduled Mandatory Exchange Date,

on which the Mandatory Exchange Conditions are satisfied.

Mandatory Exchange Conditions

34. Mandatory Exchange of PERLS VI is subject to all of the Mandatory Exchange Conditions being satisfied.
35. Broadly, the First Mandatory Exchange Condition is that the VWAP of Ordinary Shares on the 25th Business Day prior to the Mandatory Exchange Date is greater than 56% of the Issue Date VWAP.
36. Broadly, the Second Mandatory Exchange Condition is that the VWAP during the period of 20 Business Days prior to the Mandatory Exchange Date is greater than 50.51% of the Issue Date VWAP.
37. The Third Mandatory Exchange Condition is that Ordinary Shares have not been Delisted at the Mandatory Exchange Date.

Early Exchange

38. Exchange of PERLS VI (Early Exchange) may occur at a time before a Mandatory Exchange Date on the occurrence of certain events (defined in the Terms), being:

- a Capital Trigger Event or a Non-Viability Trigger Event; and
- a Change of Control Event.

Capital Trigger Event and Non-Viability Trigger Event

CBA must Exchange all or some PERLS VI upon the occurrence of a Capital Trigger Event or a Non-Viability Trigger Event.

Early Exchange on the occurrence of a Capital Trigger Event or Non-Viability Trigger Event is not subject to any of the Mandatory Exchange Conditions being satisfied.

Exchange of the relevant PERLS VI will be taken to have occurred immediately upon the date of occurrence of the Capital Trigger Event or Non-Viability Trigger Event.

If for any reason Exchange of any PERLS VI fails to take effect and CBA is not otherwise able to issue the Ordinary Shares required to be issued in respect of such Exchange within 5 Business Days after the date of occurrence of the relevant Event then the relevant Holder's rights (including to payment of Distributions) are immediately and irrevocably terminated.

Change of Control Event

CBA must Exchange all PERLS VI on the occurrence of a Change of Control Event.

A Change of Control Event is subject to the Second and Third Mandatory Exchange Conditions being satisfied.

General provisions applicable to Exchange

39. On Exchange:

- each Holder's rights (including in relation to payment of Distributions) in relation to each PERLS VI that is being Exchanged will be immediately and irrevocably terminated for an amount equal to the Face Value and CBA will apply the Face Value of each PERLS VI by way of payment for the subscription for the Ordinary Shares to be issued on Exchange; and
- each Holder will be allotted a number (the Exchange Number) of Ordinary Shares for each PERLS VI held by the Holder.

40. The Exchange Number (of Ordinary Shares for each PERLS VI) is calculated according to the formula set out in the Terms and is always subject to the Exchange Number being no greater than the Maximum Exchange Number, calculated according to a formula set out in the Terms.

41. An Exchange Date is also a Distribution Payment Date which means Holders will receive any Distribution entitlements up to and including the Exchange Date (subject to the Distribution Payment Conditions described in paragraph 30 of this Ruling).

Resale on the Call Date

42. On the Call Date (15 December 2018), CBA may elect to Resell all or some PERLS VI. If CBA elects to Resell PERLS VI, it will arrange for a Purchaser to undertake to purchase all PERLS VI from Holders for \$100 each (being the Face Value). On Resale, Holders will receive \$100 for each PERLS VI from the Purchaser.

Early Redemption

43. CBA may Redeem PERLS VI:

- at the option of CBA on the Call Date, being 15 December 2018;
- for inability to frank Distributions or for other tax reasons; or
- for regulatory reasons.

On Early Redemption, CBA is required to pay an amount equal to the Face Value of PERLS VI to each Holder of PERLS VI. Other than Early Redemption at the option of CBA on the Call Date, CBA may only Redeem all (but not some) of PERLS VI.

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

45. A Redemption Date is also a Distribution Payment Date which means Holders will receive any Distribution entitlements up to and including the Redemption Date (subject to the Distribution Payment Conditions described in paragraph 30 of this Ruling).

Other matters

46. The Ruling is made on the basis that:
- (a) The documents listed in paragraph 15 of this Ruling provide a complete and accurate description of the scheme and the scheme was implemented according to the terms of these documents.
 - (b) During the term of the scheme, CBA will be a resident of Australia under the income tax laws of Australia.
 - (c) PERLS VI are equity interests in CBA pursuant to Division 974 of the ITAA 1997.
 - (d) Distributions paid in respect of PERLS VI are frankable distributions under section 202-40 of the ITAA 1997 and are not unfrankable under section 202-45 of the ITAA 1997.
 - (e) CBA will frank Distributions in respect of PERLS VI at the same franking percentage as the benchmark for the franking period in which the payments are made.
 - (f) Ordinary Shares issued on Exchange of PERLS VI will be equity interests in CBA pursuant to Division 974 of the ITAA 1997.
 - (g) A Holder, and their associates, do not have any 'positions' (within the meaning of former section 160APHJ of the ITAA 1936) in relation to PERLS VI apart from the holding of PERLS VI themselves that would cause a Holder not to be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.
 - (h) A Holder and their associates will not make any 'related payments' (within the meaning of former section 160APHN of the ITAA 1936) in relation to Distributions payable in respect of PERLS VI.
 - (i) Holders will not dispose of PERLS VI before a period of at least 90 days (excluding the day of acquisition and the day of disposal) beginning the day after the acquisition of PERLS VI.
 - (j) CBA will not differentially frank Distributions to different Holders in respect of PERLS VI according to the tax status of Holders or on any other basis.

- (k) The dividend payout ratios and CBA's policies in relation to the franking of its distributions on ordinary share capital, other preference share capital and non-share equity interests of CBA (to the extent such dividends/distributions are frankable) are not expected to change as a result of the issue of PERLS VI.
- (l) The allotment of Ordinary Shares is not expected to affect CBA's dividend franking policy (which applies to its Ordinary Shares, preference shares and non-share equity interests).
- (m) Distributions and any gross-up amounts payable in respect of PERLS VI will not be debited to CBA's non-share capital account.
- (n) The share capital of CBA will not become tainted, (within the meaning of Division 197 of the ITAA 1997), by the issue of PERLS VI or Ordinary Shares on Exchange.
- (o) Distributions on PERLS VI will not be sourced, directly or indirectly, from CBA's share capital or non-share capital account.
- (p) CBA expects to continue with its policy of franking all frankable distributions (to the extent that franking credits are available in its franking account).
- (q) Immediately before payment of a Distribution of PERLS VI, CBA will have sufficient available profits (worked out under section 215-20 of the ITAA 1997) available to pay the Distribution.
- (r) If there is an Early Redemption of PERLS VI, the Redemption Amount will be debited in full to CBA's non-share capital account.
- (s) On Exchange, CBA will debit the Face Value of PERLS VI to its non-share capital account.
- (t) The Holders of PERLS VI will be the legal and beneficial owners of PERLS VI.
- (u) The accounts of the CBA group are prepared in accordance with applicable accounting standards.

Ruling

Acquisition of PERLS VI – CGT implications

Acquisition time

47. PERLS VI Holders will acquire their PERLS VI on the issue date of 17 October 2012 under item 2 of the table in section 109-10 of the ITAA 1997.

Cost base and reduced cost base

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

Inclusion of Distributions and franking credits in assessable income

49. Distributions paid in respect of each PERLS VI 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).

50. 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

51. Holders will be entitled to a tax offset equal to the franking credit received on Distributions paid in respect of PERLS VI (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

52. 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) unless any of the exceptions in Subdivision 207-E of the ITAA 1997 apply.

Franking credit subject to the refundable tax offset rules

53. 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 PERLS VI, 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

54. 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 PERLS VI.

Determination under paragraph 177EA(5)(b)

55. 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 PERLS VI.

Gross-up and tax offset denied in certain circumstances

56. Section 207-145 of the ITAA 1997 will not apply to the whole, or any part, of the Distributions paid to Holders provided that a Holder is a 'qualified person' in relation to Distributions paid on PERLS VI.

57. For the purposes of Division 1A of former Part IIIAA of the ITAA 1936, a Holder will be considered to be a 'qualified person' in relation to Distributions paid on PERLS VI provided that, pursuant to former section 160APHO of the ITAA 1936:

- the Holder holds PERLS VI at risk for a continuous 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 PERLS VI within the meaning of former sections 160APHM and 160APHJ of the ITAA 1936); and
- neither the Holder, nor an associate of the Holder, has made or is under an obligation to make a related payment (within the meaning of former section 160APHN of the ITAA 1936) in respect of Distributions.

58. The provisions in the Terms for the Resale of PERLS VI on the Call Date and the Exchange of PERLS VI will not of themselves result in a materially diminished risk of loss or opportunity for gain in respect of the PERLS VI.

Section 45

59. Section 45 of the ITAA 1936 will not apply to treat the Ordinary Shares issued on Exchange as an unfranked dividend paid by CBA.

Section 45A

60. 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 upon an Exchange of PERLS VI or an Early Redemption as an unfranked dividend in the hands of Holders.

Section 45B

61. 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 upon an Exchange of PERLS VI or an Early Redemption as an unfranked dividend in the hands of Holders.

Ordinary Shares not a dividend

62. Other than in respect of a Distribution paid on an Exchange Date, the Exchange of PERLS VI will not result in Holders being taken to have received a dividend as defined in subsection 6(1) of the ITAA 1936.

Each PERLS VI will not be a traditional security

63. Section 26BB of the ITAA 1936 will not apply to include any amount in the assessable income of the Holders upon disposal of PERLS VI.

64. Section 70B of the ITAA 1936 will not apply to allow a deduction to the Holders upon disposal of PERLS VI.

PERLS VI are convertible interests

65. Each PERLS VI is a convertible interest under item 4 of the table in subsection 974-75(1) of the ITAA 1997.

Exchange of PERLS VI – CGT implications

66. CGT event C2 (section 104-25 of the ITAA 1997) will happen for Holders on Exchange of PERLS VI for Ordinary Shares. Exchange is constituted by the PERLS VI (a convertible interest) being converted into Ordinary Shares.

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

Acquisition of Ordinary Shares on Exchange – CGT implications

Cost base and reduced cost base of Ordinary Shares

68. PERLS VI are convertible interests. On Exchange, Subdivision 130-C of the ITAA 1997 will apply so that the first element of the cost base and reduced cost base of the Ordinary Shares acquired on Exchange will be the cost base of PERLS VI at the time of Exchange (item 2 of the table in subsection 130-60(1) of the ITAA 1997).

Acquisition time of Ordinary Shares

69. Ordinary Shares acquired on Exchange of the PERLS VI (being convertible interests) will be taken to have been acquired when the conversion happened on the relevant Exchange Date (subsection 130-60(2) of the ITAA 1997).

Commissioner of Taxation

31 October 2012

Appendix 1 – Explanation

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

Acquisition time of PERLS VI

70. 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).

71. PERLS VI will be issued on 17 October 2012. Therefore, under item 2 of the table in section 109-10 of the ITAA 1997, PERLS VI Holders will acquire their PERLS VI on 17 October 2012.

Cost base and reduced cost base of PERLS VI

72. 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).

73. The Issue Price of each PERLS VI is \$100. Accordingly, when PERLS VI are issued, the first element of the cost base and reduced cost base of each PERLS VI is \$100.

Inclusion of Distributions and franking credits in assessable income

74. 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.

75. PERLS VI are equity interests under Division 974 of the ITAA 1997 and Holders are equity holders. Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which governs dividends) applies to an equity holder in the same way as it applies to a shareholder.

76. Distributions paid in respect of PERLS VI 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 PERLS VI under subparagraph 44(1)(a)(ii) of the ITAA 1936.

77. 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.

78. 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

79. 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 has been included in their assessable income in respect of Distributions they receive, 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.

Franking credit subject to the refundable tax offset rules

80. 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.

81. 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.

82. 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

83. Subdivision 204-D of the ITAA 1997 enables the Commissioner to make a determination where distributions with attached imputation benefits are streamed to a member of a corporate tax entity in preference to another member.

84. Section 204-30 of the ITAA 1997 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 of the ITAA 1997 applies where an entity 'streams' the payment of distributions in such a way that:

- an 'imputation benefit' is, or apart from section 204-30 of the ITAA 1997 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); and

- the other member (disadvantaged member) of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c) of the ITAA 1997).

85. Streaming is not defined for the purposes of Subdivision 204-D of the ITAA 1997. However, the Commissioner understands it to refer to a company 'selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits' (paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002).

86. The Applicant has indicated that all Holders will receive fully franked Distributions regardless of their tax attributes or their individual tax position. The dividend payout ratios and CBA's policies in relation to the franking of dividends/distributions on ordinary share capital, other preference share capital or other non-share equity interests of CBA (to the extent such dividends/distributions are frankable) are not expected to change as a result of the issue of PERLS VI.

87. Foreign residents will not be precluded from participating in the Offer, where the Offer is made in accordance with the laws of their jurisdiction.

88. The Ordinary Shares allotted on Exchange of PERLS VI will not attract the application of section 204-30 of the ITAA 1997. This is because the issue of Ordinary Shares does not constitute a distribution, and the allotment of Ordinary Shares will not affect CBA's dividend franking policy (which applies to its Ordinary Shares, preference shares and non-share equity interests).

89. 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 CBA to the Holders. Accordingly, the Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny imputation benefits to the Holders.

Determination under paragraph 177EA(5)(b) of the ITAA 1936

90. 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:

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

91. 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:
 - (1) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (2) 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.

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

- (a) applies to a non-share equity interest in the same way as it applies to a membership interest; and
- (b) applies to an equity holder in the same way as it applies to a member; and
- (c) applies to a non-share dividend in the same way as it applies to a distribution.

92. 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 PERLS VI and the issue of Ordinary Shares on Exchange 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, a 'scheme for a disposition of membership interests or an interest in membership interests' includes a scheme that involves the issuing of membership interests.

Pursuant to paragraph 177EA(12)(a) of the ITAA 1936, section 177EA applies to a non-share equity interest in the same way as it applies to a membership interest.

Therefore as PERLS VI 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 PERLS VI will be frankable distributions to the extent that the Distributions on PERLS VI do not fall within the list in 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, CBA 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 CBA expects to frank the Distributions on PERLS VI (paragraph 177EA(3)(d) of ITAA 1936).

93. 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 to obtain an imputation benefit.

94. 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.

95. 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.

96. The Commissioner considers that a number of the relevant circumstances of the present arrangement go some way towards indicating a non-incidental purpose of enabling a relevant taxpayer to obtain an imputation benefit. In particular, the calculation of the Distribution by reference to the corporate tax rate, and the Adjustment to calculation of Distributions if not fully franked would be matters going to paragraph (f) of subsection 177EA(17) of the ITAA 1936 and are of significance for the ascertainment of the relevant purpose.

97. However, based on the information provided and the qualifications set out in this Ruling, the Commissioner's consideration of all of the relevant circumstances of the scheme would not, on balance, lead to a conclusion that the purpose of enabling Holders to obtain imputation benefits is more than incidental to CBA's purpose of raising Tier 1 Capital to meet the new capital adequacy requirements under Basel III.

98. Accordingly, the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 that would deny the imputation benefits to the Holders.

Gross-up and tax offset denied in certain circumstances

99. 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.

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

101. A person is a 'qualified person' for the purposes of Division 1A of former Part IIIA 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).

102. By virtue of the 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.

103. 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).

104. 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).

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

- the Holder held their PERLS VI at risk for 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 PERLS VI and ending on the 90th day after the day on which PERLS VI 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 PERLS VI (former paragraph 160APHO(1)(a) of the ITAA 1936 and former section 160APHN of the ITAA 1936).

106. 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.

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

108. 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)

109. Under the Resale mechanism, CBA can elect to require some or all Holders to sell their PERLS VI to the Purchaser. The Purchaser, until selected by CBA, has no right or ability to trigger Resale for PERLS VI from the Holders.

110. CBA is not required to exercise the Resale mechanism and has not elected the Purchaser. It follows that the Resale mechanism is an option that is held by CBA, as the issuer of the share, and not by a third party. The Resale mechanism therefore does not represent a separate position in relation to PERLS VI for the purposes of former Division 1A of Part IIIAA of the ITAA 1936.

111. Similarly, although the Exchange mechanism will affect the exchange of PERLS VI for Ordinary Shares, the Exchange will not represent a separate position for the purposes of former Division 1A of Part IIIAA of the ITAA 1936. This is because the Holders do not have the right to elect Exchange or Early Exchange. Also, CBA has no obligation to Exchange.

112. Therefore, the Commissioner has concluded that the Resale and Exchange mechanism will not of themselves affect a Holder's risks of loss or opportunities for gain in respect of PERLS VI.

113. 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 PERLS VI or to dividends paid on Ordinary Shares issued on Exchange of PERLS VI.

114. A distribution will be 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.

115. The Prospectus provides no indication that the offering of PERLS VI and the associated payment of franked Distributions to Holders in any way constitutes a dividend stripping arrangement.

Section 45

116. 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%.

117. CBA has consistently paid fully franked dividends on Ordinary and Preference share capital and fully franked distributions on non-share equity interests (to the extent such dividends/distributions are frankable) CBA has stated its intention to continue paying such fully franked dividends/distributions to all its shareholders and non-share equity holders into the foreseeable future. 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 Ordinary Shares on Exchange as an unfranked dividend in the hands of Holders.

Section 45A

118. 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).

119. The Commissioner may make a determination under subsection 45(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.

120. 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 Ordinary Shares to Holders on Exchange of PERLS VI will constitute the provision of capital benefits

121. The issue of Ordinary Shares on Exchange of PERLS VI is in effect a restatement of the Holder's interest in the capital of CBA. In the absence of any other factors that would contribute to an alternative conclusion, there will not be any streaming of capital benefits.

122. An Early Redemption will involve the provision of a capital benefits 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 Early Redemption is limited to the amount of the Face Value of PERLS VI and any Distribution entitlements on PERLS VI will be separately paid as Distributions given that a Redemption Date will also be a Distribution Payment Date under the Terms.

123. Accordingly, it cannot be said that Holders would derive a greater benefit from capital benefits than other CBA shareholders. Therefore, an Early Redemption or the issue of Ordinary Shares on Exchange will not trigger the application of section 45A of the ITAA 1936.

124. Accordingly the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936.

Section 45B

125. 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.

126. 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.

127. The issue of Ordinary Shares to Holders on Exchange will constitute a scheme under which the Holders are provided with a capital benefit by CBA (paragraph 45B(5)(a) of the ITAA 1936). Similarly, an Early Redemption will also constitute a scheme under which the Holders are provided with a capital benefit by CBA (paragraph 45B(5)(b) of the ITAA 1936 (subsection 45B(7) of the ITAA 1936).

128. 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.

129. Having regard to the relevant circumstances surrounding the issue of PERLS VI, it cannot be concluded that CBA, the Holders or any other person entered into or carried out the issue of PERLS VI for the purpose of enabling Holders to obtain a capital benefit.

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

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

Ordinary Shares not a dividend

132. The issue of Ordinary Shares to the PERLS VI Holders on Exchange is a distribution of property to holders of a non-share equity interest 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.

133. 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.

134. On Exchange, CBA will debit the Face Value of PERLS VI to its non-share capital account. Accordingly, the issue of Ordinary shares on Exchange is not a non-share dividend and will not be included in assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

Each PERLS VI will not be a traditional security

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

136. 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.

137. PERLS VI is not stock, a bond, debenture, certificate of entitlement, bill of exchange, or a promissory note.

138. 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).

139. Paragraphs (b) and (c) of the definition of security do not apply because PERLS VI is neither a deposit with a bank or other financial institution, nor a secured or unsecured loan.

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

141. The Terms do not evidence a liability by CBA to pay an amount or amounts to Holders of PERLS VI during the term of the instrument or at maturity.

142. PERLS VI are perpetual and Holders do not have a right to require redemption. The payment by CBA of Distributions is subject to the Distribution Payment Conditions. Distributions are discretionary and non-cumulative and if a Distribution is not paid, CBA has no liability to pay the Distribution and Holders have no claim in respect of non-payment. Upon Exchange, CBA will allot and issue a number of ordinary shares based on a formula set out in the Terms for each PERLS VI held by the Holder. Each Holder's rights in relation to each PERLS VI that is being exchanged are immediately and irrevocably terminated for an amount equal to Face Value and CBA will apply that amount by way of payment for the subscription for Ordinary Shares issued to Holders. CBA cannot be said to have a liability to pay an amount under the Terms of PERLS VI pursuant to the Exchange.

143. Early Redemption of PERLS VI is possible. However it is at the option of CBA or will only occur upon the happening of certain events and requires the prior written approval of APRA. This does not establish a liability on CBA to pay an amount.

144. CBA is also not liable to pay an amount upon wind-up under PERLS VI as it would be expected that PERLS VI would either be Exchanged into Ordinary Shares pursuant to a Capital Trigger Event or a Non-Viability Trigger Event (in which case any distribution would be made to the Holders as ordinary shareholders as opposed to under the terms of PERLS VI), or Holders rights would be terminated where CBA is not able to issue Ordinary Shares within the time stated in the Terms.

145. As PERLS VI is 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.

PERLS VI are convertible interests

146. 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 that is an interest that will, or may, convert into an equity interest in the company.

147. 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);
- 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).

148. Each PERLS VI is a convertible interest because it will or may be redeemed, repaid or satisfied by the issue of Ordinary Shares upon Exchange.

Exchange of PERLS VI – CGT implications

149. CGT event C2 will happen to Holders on Exchange of PERLS VI. 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.

150. PERLS VI are convertible interests. The Exchange of PERLS VI for Ordinary Shares constitutes the conversion of a convertible interest.

151. The Exchange of PERLS VI 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 Exchange of PERLS VI will be disregarded.

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Previous draft:

Not previously issued as a draft

*Related Rulings/Determinations:*TR 96/14; TR 2006/10;
TD 2007/29*Subject references:*

- acquisition dates
- anti-avoidance measures
- capital gains tax
- CGT cost base
- convertible interests
- dividend imputation
- franking tax offset
- imputation benefits
- qualified persons
- streaming of imputation benefit

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