Class Ruling

Income tax: National Australia Bank Limited – issue of NAB Capital Notes

Contents Para

This publication provides you with the following level of protection:

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

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

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

What this Ruling is about

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

Relevant provision(s)

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

- section 26BB of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) of the ITAA 1936
- section 45 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 159GP of the ITAA 1936
- section 177EA of the ITAA 1936
- Division 1A of former Part IIIAA of the ITAA 1936
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)

- Division 104 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
- Subdivision 130-C of the ITAA 1997
- section 204-30 of the ITAA 1997
- Division 207 of the ITAA 1997
- section 974-75 of the ITAA 1997
- section 974-120 of the ITAA 1997
- section 974-165 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise stated.

Class of entities

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

- are residents of Australia within the meaning of subsection 6(1) of the ITAA 1936 during the period in which they hold NAB Capital Notes
- hold their NAB Capital Notes on capital account, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their NAB Capital Notes.

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

4. In this Ruling the class of entities is referred to as the Holders.

5. The class of entities to which this Ruling applies does not extend to holders of NAB Capital Notes who do not acquire their NAB Capital Notes by initial application under the Prospectus relating to the offer of NAB Capital Notes lodged with the Australian Securities and Investments Commission on 25 February 2015 (Prospectus).

Qualifications

6. This Ruling does not consider the tax implications of the Redemption or Resale of NAB Capital Notes.

7. This Ruling does not consider how the taxation law applies to a Nominated Purchaser who acquires their NAB Capital Notes under the Resale facility.

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

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 62 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

11. This Ruling applies from 1 July 2014 to 30 June 2022. The Ruling continues to apply after 30 June 2022 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

12. The following description of the scheme is based on information provided by Greenwoods & Herbert Smith Freehills Pty Limited (on behalf of NAB). The following documents (Transaction Documents), or relevant parts of them, form part of and are to be read with this description:

- application for Class Ruling dated 12 December 2014
- prospectus for the issue of NAB Capital Notes dated 25 February 2015 (Prospectus)
- the NAB Capital Notes Terms found in Appendix A of the Prospectus (Terms), and
- further correspondence and additional information from Greenwoods & Herbert Smith Freehills Pty Limited.

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 Terms and the Prospectus.

14. NAB is an Australian resident company for income tax purposes and is listed on the Australian Securities Exchange (ASX).

15. NAB is an authorised deposit-taking institution for the purposes of the *Banking Act 1959* and is subject to regulatory compliance requirements by the Australian Prudential Regulation Authority (APRA), including maintenance of mandatory levels of Tier 1 Capital.

16. NAB announced its intention under the Prospectus to undertake a capital raising by the issue of NAB Capital Notes for an issue price of $100 each to raise $1.25 billion (with the ability to raise more or less) (Offer).

17. APRA confirmed that the NAB Capital Notes are Additional Tier 1 Capital for the purposes of the Prudential Standard APS 111.

18. The issue date for the NAB Capital Notes is 23 March 2015.

19. The NAB Capital Notes will be listed on the ASX and trade under the ASX code NABPC.

20. Investors can apply for the NAB Capital Notes under:

(a) the Securityholder Offer, which is available to registered holders of ordinary shares in NAB (Ordinary Shares) and certain other capital instruments as at 12 February 2015 shown on the Register as having an address in Australia

(b) the Institutional Offer, which is available to certain Institutional Investors, or

(c) the Broker Firm Offer, which is available to clients of a Syndicate Broker who are Australian residents.

21. The NAB Capital Notes may be offered in a jurisdiction outside Australia by the joint lead managers where such an offer is made in accordance with the laws of that jurisdiction.

Reasons for issuing the NAB Capital Notes

22. The Offer has been made as part of NAB's ongoing capital management strategy within the regulatory capital requirements prescribed by APRA. The issue of the NAB Capital Notes is a new capital raising and is not for the purpose of refinancing any securities that NAB currently has on issue. The proceeds from the issue of the NAB Capital Notes are to be used by NAB for general corporate purposes.

Main features of the NAB Capital Notes

23. The NAB Capital Notes are fully paid, mandatorily convertible, subordinated, perpetual debt securities issued by NAB in Australia.

24. The Issue Price and Face Value of each NAB Capital Note is $100.

25. A Holder does not have voting rights at a general meeting of NAB.

Distribution calculation

26. Subject to the conditions in paragraph 28, a Holder is entitled to receive, on the relevant Distribution Payment Date, a Distribution payable only in cash and calculated according to the following formula:

> **Distribution = (Distribution Rate x $100 x N) / 365**
>
> where:
>
> **N** is the number of days in the Distribution Period.
>
> **Distribution Rate** (expressed as a percentage per annum) is calculated using the following formula:
>
> **Distribution Rate = (Bank Bill Rate + Margin) x (1 – Tax Rate)**
>
> where:
>
> **Bank Bill Rate** (expressed as a percentage per annum) means, for a Distribution Period, the average mid-rate for bills of a term of 90 days which average rate is displayed on Reuters page BBSW (or any page which replaces that page) on the Issue Date in the case of the first Distribution Period, and in the case of any other Distribution Period the first Business Day of the Distribution Period or, if there is a manifest error in the calculation of that average rate or that average rate is not displayed by 10:30am (Australian eastern standard time) on that date, the rate specified in good faith by NAB at or around that time on that date having regard, to the extent possible, to:
>
> (a) the rates otherwise bid and offered for bank bills of a term of 90 days or for bank funds of that tenor displayed on Reuters page BBSW (or any page which replaces that page) at that time on that date, or
>
> (b) if bid and offer rates for bank bills of a term of 90 days are not otherwise available, the rates otherwise bid and offered for bank funds of that tenor at or around that time on that date.
>
> **Margin** means 3.50% per annum.
>
> **Tax Rate** (expressed as a decimal) means the Australian corporate tax rate applicable to the franking account of NAB on the relevant Distribution Payment Date.

27. The Distributions are expected to be fully franked. However, if a Distribution is not franked to 100%, the Distribution will be calculated according to the following formula:

> **Distribution = D / [1 – [Tax Rate * (1 – F)]]**
>
> where:
>
> **D** means the Distribution calculated according to the formula set out in paragraph 26 of this Ruling
>
> **F** means the applicable Franking Rate

Distribution payment conditions

28. Each Distribution is subject to the following conditions:

(a) the directors of NAB, in their sole discretion, resolve to pay the relevant Distribution on the relevant Distribution Payment Date

(b) the payment of the Distribution does not result in NAB or the Group not complying with APRA's then current Prudential Capital Requirements

(c) unless APRA otherwise approves in writing, the Distribution payment would not result in NAB or the Group exceeding any limit on distributions of earnings applicable under (and calculated in accordance with) APRA's then current capital conservation requirements as they are applied to NAB or the Group (as the case may be) at the time

(d) APRA not otherwise objecting to the payment of the Distribution

(e) the payment of the Distribution not resulting in NAB becoming, or being likely to become, insolvent for the purposes of the *Corporations Act 2001*, and

(f) NAB being permitted to pay the Distribution under the *Corporations Act 2001*.

29. Distributions are non-cumulative and if all or any part of a Distribution is not paid, Holders have no claim or entitlement in respect of such non-payment, and such non-payment does not constitute an event of default.

30. No interest accrues on any unpaid Distributions and the Holders have no claim or entitlement in respect of interest on any unpaid Distributions.

31. Subject to the Terms, NAB shall pay a Distribution in respect of a NAB Capital Note on the following dates (each a Distribution Payment Date):

(a) each 23 March, 23 June, 23 September and 23 December, commencing on 23 June 2015 until (but not including) the date on which the NAB Capital Note is Converted or Redeemed in accordance with the Terms, and

(b) each date on which a Conversion, Redemption or Resale of that NAB Capital Note occurs in accordance with the Terms.

32. A Distribution is only payable on a Distribution Payment Date to the person registered as the holder of the NAB Capital Note on the Record Date for that Distribution.

Terms of the NAB Capital Notes

33. The Holders may have their NAB Capital Notes Redeemed, Converted or Resold by NAB according to the Terms.

Conversion

34. Conversion of the NAB Capital Notes involves the following:

(a) each Holder is issued a number of Ordinary Shares for each NAB Capital Note that is being Converted on the Conversion Date equal to the Conversion Number

(b) each Holder's rights (including to payment of Distributions, other than the Distribution, if any, payable on a Conversion Date that is not a Loss Absorption Event Conversion Date) in relation to each NAB Capital Note that is being Converted is immediately and irrevocably terminated for an amount equal to the Face Value and NAB applies the Face Value by way of payment for the subscription of the Conversion Number of Ordinary Shares to be issued on Conversion.

35. Upon Conversion of the NAB Capital Notes, all other rights conferred or restrictions imposed on that NAB Capital Note under the Terms no longer have effect (except for accrued rights).

36. Each Ordinary Share allotted upon Conversion ranks equally with all other fully paid Ordinary Shares.

Mandatory Conversion

37. All NAB Capital Notes must Convert into Ordinary Shares on the Mandatory Conversion Date.

38. The Mandatory Conversion Date is the first to occur of the following dates, on which the Mandatory Conversion Conditions are satisfied:

(a) 23 March 2022 (Scheduled Mandatory Conversion Date), or

(b) the first Distribution Payment Date after the Scheduled Mandatory Conversion Date.

39. The Mandatory Conversion Conditions for the Mandatory Conversion Date are:

(a) the volume weighted average price (VWAP) of Ordinary Shares on the 25th Business Day immediately preceding (but not including) the Mandatory Conversion Date is greater than 56% of the Issue Date VWAP

(b) the VWAP of Ordinary Shares during the period of 20 Business Days on which trading in Ordinary Shares took place immediately preceding (but not including) the Relevant Mandatory Conversion Date is greater than 50.51% of the Issue Date VWAP, and

(c) no Delisting Event applies in respect of the Mandatory Conversion Date.

Mandatory Conversion on Loss Absorption Event

40. A Loss Absorption Event is each of:

(a) a Common Equity Trigger Event, and

(b) a Non-Viability Trigger Event.

41. A Common Equity Trigger Event occurs when either or both of the Common Equity Tier 1 Ratio in respect of the NAB Level 1 Group and the NAB Level 2 Group as determined by NAB or APRA at any time is equal to or less than 5.125%.

42. If a Common Equity Trigger Event occurs, NAB must immediately convert into Ordinary Shares or write off:

(a) all Relevant Tier 1 Capital Instruments, or

(b) a proportion of the Relevant Tier 1 Capital Instruments if APRA is satisfied that conversion or write off of that proportion will have the result that each of the Common Equity Tier 1 Ratio in respect of the NAB Level 1 Group and the Common Equity Tier 1 Ratio in respect of the NAB Level 2 Group is at a percentage above 5.125% determined by NAB for that ratio.

43. A Non-Viability Trigger Event means APRA has provided a written determination to NAB that the conversion into Ordinary Shares or write off of Relevant Tier 1 Capital Instruments in accordance with their terms or by operation of law is necessary because:

(a) without the conversion or write off, APRA considers that NAB would become non-viable, or

(b) without a public sector injection of capital or equivalent capital support with respect to NAB, APRA considers that NAB would become non-viable.

44. If a Non-Viability Trigger Event occurs, NAB must immediately convert into Ordinary Shares or write off all Relevant Tier 1 Capital Instruments, or a proportion of the Relevant Tier 1 Capital Instruments to the extent APRA is satisfied that the conversion or write off will ensure that NAB does not become non-viable.

45. If, for any reason, Conversion has not been effected within 5 days after the Loss Absorption Event Conversion Date, then Conversion on account of the Loss Absorption Event does not apply and those NAB Capital Notes are Written Off.

Mandatory Conversion on Acquisition Event

46. On the occurrence of an Acquisition Event, NAB must Convert all of the NAB Capital Notes on the Acquisition Conversion Date. An Acquisition Event is, broadly, one of the following events, provided that it is not a non-operating holding company event (NOHC Event):

(a) a takeover bid is made to acquire all or some of the Ordinary Shares and such offer is, or becomes, unconditional, all regulatory approvals have been obtained and either the bidder has at any time during the offer period a relevant interest in more than 50% of the Ordinary Shares on issue, or a majority of the directors of NAB (who are eligible to do so) recommend acceptance of the takeover offer, or

(b) a court approves a scheme of arrangement under Part 5.1 of the *Corporations Act 2001*, which when implemented results in a person having a relevant interest in more than 50% of the Ordinary Shares.

Optional Conversion by NAB

47. Subject to APRA's prior written approval, NAB may elect to Convert:

(a) all or some NAB Capital Notes on an Optional Conversion Date following the occurrence of a Tax Event or a Regulatory Event

(b) all or some NAB Capital Notes on an Optional Conversion Date following the occurrence of a Potential Acquisition Event, or

(c) all or some NAB Capital Notes on 23 March 2020.

48. A Holder does not have the right to request Conversion at any time.

Optional Redemption by NAB

49. NAB may, with APRA's prior written approval, elect to Redeem:

(a) all or some NAB Capital Notes on a Redemption Date following the occurrence of a Tax Event or a Regulatory Event, or

(b) all or some NAB Capital Notes on 23 March 2020.

50. The NAB Capital Notes are Redeemed by payment on the Redemption Date of an amount equal to the Face Value to the Holder.

51. A Holder does not have the right to request Redemption at any time.

Optional Resale

52. NAB may, with APRA's prior written approval, elect to Resell:

(a) all or some NAB Capital Notes on a Resale Date following the occurrence of a Tax Event or a Regulatory Event, or

(b) all or some NAB Capital Notes on 23 March 2020.

53. If NAB elects to Resell NAB Capital Notes, NAB must appoint one or more Nominated Purchasers for the Resale on such terms as may be agreed between NAB and the Nominated Purchasers.

54. Each Holder on the Resale Date is taken irrevocably to offer to sell NAB Capital Notes to the Nominated Purchaser(s) on the Resale Date for the Resale Price. The Resale Price, for a NAB Capital Note, means a cash amount equal to its Issue Price.

55. On the Resale Date subject to payment by the Nominated Purchaser of the Resale Price to the Holders, all right, title and interest in such NAB Capital Note (excluding the right to any Distribution payable on that date) is transferred to the Nominated Purchaser free from Encumbrances.

Ranking and subordination

56. NAB Capital Notes rank in respect of payment of Distributions:

(a) in priority to Ordinary Shares

(b) equally and without any preference amongst themselves and all Equal Ranking Instruments, and

(c) junior to the claims of all Senior Creditors.

57. In a winding up of NAB in Australia, a NAB Capital Note confers upon its Holder, subject to the Terms, the right to a cash payment of the Face Value on a subordinated basis, but no further or other claim on NAB.

58. The Holders rank for receipt of the Face Value in a winding up of NAB:

(a) in priority to Ordinary Shares

(b) equally among themselves and with the claims of all Equal Ranking Instruments, and

(c) junior to the claims of all Senior Creditors.

Substitution of Approved NOHC as issuer of Ordinary Shares

59. The Terms provide for the substitution of an Approved NOHC as the issuer of ordinary shares on the Conversion of the NAB Capital Notes. A NOHC is defined as a non-operating holding company within the meaning of the *Banking Act 1959*.

60. A NOHC Event is an event which would otherwise be an Acquisition Event which is initiated by the Directors and the result of which is that the ultimate holding company of NAB is a NOHC.

61. NAB may give a notice to the Holders before the NOHC Event occurs specifying the amendments to the Terms which is made to effect the substitution of an Approved NOHC as the issuer of ordinary shares of the Approved NOHC to Holders on Conversion of the NAB Capital Notes. This means that, on Conversion, each NAB Capital Note that is being Converted is automatically transferred by each Holder to the Approved NOHC (or another entity which meets the stated criteria) and each Holder (or in certain circumstances a nominee) is issued a number of ordinary shares in the capital of the Approved NOHC equal to the Conversion Number.

Other matters

62. The Ruling is made on the basis that:

(a) During the term of the scheme NAB is a resident of Australia under the income taxation laws of Australia and of no other jurisdiction.

(b) The NAB Capital Notes are equity interests in NAB under Division 974 and are non-share equity interests as defined in subsection 995-1(1).

(c) The Distributions are frankable distributions under section 202-40.

(d) In accordance with Division 203, NAB will frank Distributions in respect of the NAB Capital Notes at the same franking percentage as the NAB benchmark for the franking period in which the frankable distribution is made.

(e) Distributions on the NAB Capital Notes are not sourced, directly or indirectly, from NAB's share capital account or its non-share capital account.

(f) Immediately before the payment of a Distribution on the NAB Capital Notes, NAB has available frankable profits (worked out under section 215-20) at least equal to the Distribution.

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

(h) NAB does not differentially frank Distributions to different Holders according to their tax status or on any other basis.

(i) The dividend payout ratios and NAB's policies in relation to the franking of its distributions on ordinary share capital and other preference share capital of NAB (to the extent such dividends/distributions are frankable) are not expected to change as a result of the issue of the NAB Capital Notes.

(j) The share capital account of NAB does not become tainted (within the meaning of Division 197) by the issue of the NAB Capital Notes or the allotment of Ordinary Shares on Conversion of the NAB Capital Notes.

(k) On Conversion or Redemption of the NAB Capital Notes, NAB debits the Face Value of the NAB Capital Notes to its non-share capital account.

(l) Ordinary Shares issued to the Holders on Conversion of the NAB Capital Notes are equity interests under Division 974.

(m) If an Approved NOHC is the ultimate holding company of NAB, the Approved NOHC ordinary shares issued to the Holders on Conversion of the NAB Capital Notes are equity interests under Division 974.

(n) Holders, and their associates, have not taken and will not take any positions (within the meaning of former section 160APHJ of the ITAA 1936) in relation to their NAB Capital Notes (apart from the holding of the NAB Capital Notes) 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.

(o) Holders and their associates will not make any related payments (within the meaning of former section 160APHN of the ITAA 1936) in respect of the Distributions.

(p) The Holders in receipt of Distributions will have held their NAB Capital Notes for a period of at least 90 days (excluding the day of acquisition and the day of disposal of their NAB Capital Notes) within the primary qualification period in relation to at least one of the Distributions, which period begins on the day after the day on which the Holder acquired their NAB Capital Notes and ends on the 90th day after the day on which the NAB Capital Notes became ex dividend.

(q) The accounts of the NAB group are prepared in accordance with the applicable accounting standards.

Ruling

Acquisition time of the NAB Capital Notes

63. Holders acquire their NAB Capital Notes on 23 March 2015, being the date the NAB Capital Notes are issued to them (item 2 of the table in section 109-10).

Cost base and reduced cost base of the NAB Capital Notes

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

Inclusion of Distributions and franking credits in assessable income

65. Holders must include in their assessable income all Distributions received (subparagraph 44(1)(a)(ii) of the ITAA 1936) and the amount of the franking credits attached to the Distributions (subsection 207-20(1)), unless Subdivision 207-D applies.

Entitlement to a tax offset

66. Holders are entitled to a tax offset equal to the franking credit on the Distributions under subsection 207-20(2), 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 apply.

67. Holders entitled to a franking credit tax offset under subsection 207-20(2) are subject to the refundable tax offset rules in Division 67. Certain trustees and corporate tax entities are excluded from the refundable tax offset rules under section 67-25.

Imputation benefits – streaming

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

Section 177EA of the ITAA 1936

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

Gross-up and tax offset

70. Section 207-145 will not apply to the whole or any part of the Distributions received by the Holders in respect of the NAB Capital Notes. Accordingly, section 207-145 will not adjust the Holders' assessable income to exclude the amount of the franking credit on the Distributions, nor will it deny the tax offset to which the Holders would otherwise be entitled.

Qualified person – the Resale facility and the Conversion mechanism

71. For the purpose of determining whether a Holder is a 'qualified person' under Division 1A of former Part IIIAA of the ITAA 1936, neither the Resale facility nor the Conversion mechanism affects a Holder's risks of loss or opportunities for gain in respect of the NAB Capital Notes. This is because neither the Resale facility nor the Conversion mechanism constitutes a separate position (former sections 160APHM and 160APHJ of the ITAA 1936).

Each NAB Capital Note is not a traditional security

72. A NAB Capital Note is not a 'traditional security' as defined in subsection 26BB(1) of the ITAA 1936.

73. A gain on the disposal or redemption of a NAB Capital Note does not give rise to assessable income under subsection 26BB(2) of the ITAA 1936. A loss on the disposal or redemption of a NAB Capital Note does not give rise to an allowable deduction under subsection 70B(2) of the ITAA 1936.

Each NAB Capital Note is a convertible interest

74. The NAB Capital Notes are convertible interests under item 4 of the table in subsection 974-75(1).

Conversion of NAB Capital Notes – CGT implications

75. CGT event C2 happens on Conversion of NAB Capital Notes for Ordinary Shares (section 104-25). As each NAB Capital Note is a convertible interest, any capital gain or capital loss made by a Holder from CGT event C2 happening is disregarded (subsection 130-60(3)).

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

76. On Conversion, the first element of the cost base and reduced cost base of each Ordinary Share acquired on Conversion is the pro-rata portion of the Holder's cost base and reduced cost base of their NAB Capital Notes at the time of Conversion (item 2 of the table in subsection 130-60(1)).

Acquisition time of Ordinary Shares on Conversion

77. Ordinary Shares allotted on Conversion are taken to be acquired at the time of the Conversion of the NAB Capital Notes (subsection 130-60(2)).

NAB Capital Notes that are Written Off – CGT implications

78. CGT event C2 happens when the NAB Capital Notes are Written Off because the NAB Capital Notes are terminated at that time (section 104-25).

79. For the purposes of determining whether the Holders make a capital gain or a capital loss from CGT event C2 happening in respect of their NAB Capital Notes, the Holders are taken to have nil capital proceeds from CGT event C2 happening. This is because the Holders receive no capital proceeds in respect of a Write Off happening, and the NAB Capital Notes have a market value of nil at that time.

Issue of Ordinary Shares on Conversion not a dividend or a non-share dividend

80. The issue of Ordinary Shares on Conversion is not a dividend within the meaning of subsection 6(1) of the ITAA 1936, nor is taken to be a non-share dividend within the meaning of section 974-120.

Application of sections 45, 45A and 45B of the ITAA 1936

Section 45 of the ITAA 1936

81. Section 45 of the ITAA 1936 does not apply to treat the value of the Ordinary Shares issued to the Holders on Conversion as an unfrankable dividend paid by NAB to the Holders.

Section 45A of the ITAA 1936

82. 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 NAB Capital Notes as an unfranked dividend in the hands of Holders.

Section 45B of the ITAA 1936

83. 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 NAB Capital Notes as an unfranked dividend in the hands of Holders.

Amendment of the Terms to substitute an Approved NOHC

84. CGT event H2 happens if the Terms are amended to effect the substitution of an Approved NOHC as the issuer of ordinary shares to the Holders on Conversion (section 104-155).

85. However, the Holders do not make a capital gain or a capital loss from CGT event H2 happening as there are no capital proceeds or incidental costs incurred because of the amendment of the Terms.

Conversion of each NAB Capital Note and the issue of ordinary shares in an Approved NOHC – CGT implications

86. Where an Approved NOHC becomes the ultimate holding company of NAB, the Conversion of NAB Capital Notes and the issue of Approved NOHC ordinary shares to the Holders results in CGT event C2 happening as it is the conversion of a convertible interest (section 104-25).

87. As the Approved NOHC ordinary shares are equity interests (within the meaning of Division 974) any capital gain or capital loss that the Holders make from CGT event C2 happening when the NAB Capital Notes are Converted to ordinary shares in an Approved NOHC is disregarded (section 130-60(3)).

Cost base of the Approved NOHC ordinary shares

88. The first element of the cost base and the reduced cost base of each Approved NOHC ordinary share issued to the Holders is calculated as the cost base of their NAB Capital Notes at the time of Conversion divided by the number of Approved NOHC ordinary shares they receive (item 2 of the table in subsection 130-60(1)).

Acquisition time of the Approved NOHC ordinary shares

89. The Holders are taken to have acquired their Approved NOHC ordinary shares at the time of Conversion (subsection 130-60(2)).

Commissioner of Taxation
25 March 2015

Appendix 1 – Explanation

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

Acquisition time of the NAB Capital Notes

90. 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).

91. The Holders acquire their NAB Capital Notes on the issue date, being the date that the NAB Capital Notes are issued. Accordingly, under item 2 in the table contained in section 109-10, the NAB Capital Notes will be acquired on 23 March 2015.

Cost base and reduced cost base of the NAB Capital Notes

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

93. The Issue Price of each NAB Capital Note is $100. Accordingly, the first element of a Holder's cost base and reduced cost base of each NAB Capital Note is $100.

Inclusion of Distributions and franking credits in assessable income

94. The assessable income of a resident shareholder includes all dividends and non-share dividends that are paid to the shareholder by the company (paragraph 44(1)(a) of the ITAA 1936).

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

96. Distributions in respect of the NAB Capital Notes are non-share distributions under section 974-115.

97. As the Distributions are not debited against NAB's non-share capital account or share capital account the Distributions are non-share dividends under section 974-120. Accordingly, Holders must include Distributions received in their assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

98. Under the Australian imputation system, where an Australian resident company makes a franked distribution directly to a shareholder, the assessable income of the shareholder must also include the amount of the franking credit on the distribution pursuant to subsection 207-20(1). The inclusion of both the dividend and the attached franking credit in a shareholder's assessable income is known as 'grossing-up' the dividend.

99. NAB expects the Distributions to be franked. Holders must include in their assessable income the amount of any franking credit attached to a Distribution in the income year in which the Distribution is made.

Entitlement to a tax offset

100. The Holders are entitled to a tax offset equal to the franking credit on the Distributions (subsection 207-20(2)).

101. Holders who are entitled to a franking credit tax offset under subsection 207-20(2) are subject to the refundable tax offset rules in Division 67, unless specifically excluded under section 67-25. 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.

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

103. Entities excluded by section 67-25 include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions in subsections 67-25(1C) or 67-25(1D).

Imputation benefits – streaming

104. Subdivision 204-D empowers 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.

105. Section 204-30 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 applies where a corporate tax entity 'streams' the payment of distributions, or the payment of distributions and the giving of other benefits, to its members in such a way that:

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

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

(a) That a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a)), or

(b) That no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination (paragraph 204-30(3)(c)).

107. 'Streaming' is not defined for the purposes of Subdivision 204-D however paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002 provides that it is 'selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits'.

108. The NAB Capital Notes are listed on the ASX and as such are available for investment by different types of investors. NAB will not differentially frank distributions payable to different Holders according to the tax status of the Holder or on any other basis. NAB expects to continue with its policy of franking all frankable distributions (to the extent of the franking credits in its franking account). The dividend payout ratios and NAB's policies in relation to the franking of dividends/distributions on Ordinary Shares and other preference share capital of NAB (to the extent such dividends/distributions are frankable) are not expected to change as a result of the issue of the NAB Capital Notes. Accordingly, it cannot be said that NAB will selectively direct the flow of franked distributions to those members who could most benefit from the franking credits.

109. Further, the Ordinary Shares issued on Conversion of the NAB Capital Notes do not attract the application of section 204-30 because the issue of the Ordinary Shares does not constitute a 'distribution' (as defined in section 960-120).

110. 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 NAB to the Holders. Accordingly the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits that are to be received by the Holders in respect of the Distributions paid.

Section 177EA of the ITAA 1936

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

- debit the company's franking account (paragraph 177EA(5)(a) of the ITAA 1936), or
- deny the imputation benefit on the distribution that flowed directly or indirectly to each shareholder (paragraph 177EA(5)(b) of the ITAA 1936).

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

(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.

113. The conditions of paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied in respect of the Scheme because:

(a) The issue of the NAB Capital Notes is a scheme for a disposition of membership interests in a corporate tax entity. Paragraph 177EA(12)(a) of the ITAA 1936 applies to treat non-share equity interests in the same way as membership interests for the purposes of section 177EA of the ITAA 1936.

(b) Distributions are frankable distributions and are expected to be payable to Holders in respect of their NAB Capital Notes.

(c) Distributions on the NAB Capital Notes are expected to be franked distributions.

(d) The Holders could reasonably be expected to receive an imputation benefit as a result of the Distributions, as NAB expects to frank Distributions.

114. 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.

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

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

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

Gross up and tax offset

118. Subdivision 207-F 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.

119. Under subsection 207-145(1), the adjustment occurs 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))
- 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))
- the Commissioner has made a determination under paragraph 204-30(3)(c) that no imputation benefit is to arise in respect of the distribution for the entity (paragraph 207-145(1)(c)), or
- the distribution is made as part of a dividend stripping operation (paragraph 207-145(1)(d)).

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

121. 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.

122. The holding period rule applies where neither the taxpayer nor an associate has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend, and requires the shares to have been continuously held at risk throughout the primary qualification period (former paragraph 160APHO(1)(a) of the ITAA 1936).

123. The related payments rule applies where the taxpayer or an associate has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend and requires the shares to have been continuously held at risk throughout the secondary qualification period (former subsection 160APHO(1) and former section 160APHN of the ITAA 1936).

124. A Holder is a qualified person in relation to a Distribution received in respect of their NAB Capital Notes, provided that:

- the Holder held their NAB Capital Note 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 their NAB Capital Note and ending on the 90th day after the day on which the NAB Capital Note become ex-dividend (former subsections 160APHO(2) and 160APHO(3) and former sections 160APHM and 160APHJ of the ITAA 1936), and
- neither the Holder, nor associates of the Holder, have made, are under an obligation to make, or are likely to make a related payment in relation to Distributions on their NAB Capital Notes (former paragraph 160APHO(1)(a) and former section 160APHN of the ITAA 1936).

125. If either, or both, of the above two conditions are not met, the Holder is not a ‘qualified person’ for the purposes of Division 1A of former Part IIIAA of the ITAA 1936. Subdivision 207-F creates the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for the Holder.

126. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) to deny the imputation benefit that arises in respect of a Distribution that is made.

127. A distribution will be taken to be made as part of a dividend stripping operation, under section 207-155, 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.

128. The Transaction Documents provide no indication that the offering of the NAB Capital Notes and the associated payment of franked distributions to the Holders in any way constitutes a dividend stripping arrangement. As such, the dividend stripping provisions do not apply.

129. Accordingly, section 207-145 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.

Qualified person – the Resale facility and the Conversion mechanism

130. In determining whether a shareholder is a 'qualified person' in relation to a distribution paid on their shares, every 'position' (defined in former subsection 160APHJ(2) of the ITAA 1936) in relation to the shares is taken into account in calculating the 'net position' (defined in former subsection 160APHJ(5) of the ITAA 1936) in relation to the shares. The 'net position' determines whether a shareholder has materially diminished risks of loss or opportunities for gain on a particular day in respect of shares held by the shareholder (former section 160APHM of the ITAA 1936). Under former subsection 160APHJ(2) of the ITAA 1936, a 'position' in relation to shares is anything that has a delta in relation to the shares.

131. 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).

132. Under the Resale facility, NAB may (subject to certain conditions) elect to require the Holders to sell all or some of their NAB Capital Notes to one or more Nominated Purchasers. Until NAB appoints an entity as a Nominated Purchaser, that entity has no right or ability to call for the NAB Capital Notes from the Holders.

133. NAB is also not required to elect to exercise the Resale facility. It follows that the Resale facility is an option that is held by NAB, the issuer of the NAB Capital Notes, and not by a third party. Therefore, the Resale facility does not constitute a separate 'position' in relation to the NAB Capital Notes under former subsection 160APHJ(2) of the ITAA 1936.

134. Similarly, although the Conversion mechanism effects the exchange of NAB Capital Notes for Ordinary Shares, the Conversion mechanism does not constitute a separate 'position' for the purposes of former Division 1A of Part IIIAA of the ITAA 1936 as the Holders have no right to elect for Conversion.

135. For the purpose of determining whether a Holder is a 'qualified person' in relation to the Distributions under Division 1A of former Part IIIAA of the ITAA 1936, neither the Resale facility nor the Conversion mechanism affects a Holder's risks of loss or opportunities for gain in respect of the NAB Capital Notes.

Each NAB Capital Note is not a traditional security

136. 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.

137. The term 'security' is defined in subsection 26BB(1) of the ITAA 1936 by reference to subsection 159GP(1) of the ITAA 1936. Under 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.

138. The NAB Capital Notes are not stock, a bond, debenture, certificate of entitlement, bill of exchange, or a promissory note.

139. 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' are generally recognised as debt instruments (Taxation Ruling TR 96/14).

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

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

142. The Terms do not evidence a liability of NAB to pay an amount or amounts to Holders during the term of the instrument or at maturity. NAB Capital Notes are perpetual and Holders do not have a right to require redemption. The payment by NAB of Distributions is subject to the distribution payment conditions. Distributions are discretionary and non-cumulative and if a Distribution is not paid, NAB has no liability to pay the Distribution and Holders have no claim in respect of non-payment.

143. Upon Conversion, NAB allots and issues a number of Ordinary Shares based on a formula set out in the Terms for each NAB Capital Note held by the Holder. Each Holder's rights in relation to each NAB Capital Note that is being exchanged are immediately and irrevocably terminated for an amount equal to the Face Value and NAB applies that amount by way of payment for the subscription for Ordinary Shares issued to Holders. NAB cannot be said to have a liability to pay an amount under the Terms in relation to a Conversion.

144. Early Redemption of NAB Capital Notes is possible. However it is at the option of NAB, it can only occur upon the occurrence of certain events, and it requires the prior written approval of APRA. This does not establish a liability on NAB to pay an amount.

145. NAB is also not liable to pay an amount under the NAB Capital Notes upon a wind up, as it would be expected before a wind up that the NAB Capital Notes would either be Converted into Ordinary Shares due to a Common Equity 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), or Holders' rights would be terminated where NAB is not able to issue Ordinary Shares within the time stated in the Terms.

146. The Terms do not exhibit a debt-like obligation as contemplated by paragraph (d) of the definition of 'security'.

147. As NAB Capital Notes are not a security within the meaning of subsection 159GP(1) of the ITAA 1936, they cannot be a traditional security under subsection 26BB of the ITAA 1936. Accordingly, section 26BB of the ITAA 1936 does not apply to include any gain upon disposal or redemption of the NAB Capital Notes in the assessable income of the Holder. Section 70B of the ITAA 1936 does not apply to allow a deduction to Holders upon disposal or redemption.

Each NAB Capital Note is a convertible interest

148. Subsection 995-1(1) 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). 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.

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

150. The NAB Capital Notes are convertible interests as they may be converted into another interest because of the allotment of Ordinary Shares upon Conversion.

Conversion of NAB Capital Notes – CGT implications

151. The NAB Capital Notes must convert upon the satisfaction of the Mandatory Conversion Conditions, or may convert should NAB elect to do so following the occurrence of certain defined events and subject to the satisfaction of any relevant conditions.

152. CGT event C2 happens to Holders on Conversion under paragraph 104-25(1)(f), which provides that 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.

153. As the NAB Capital Notes are convertible interests, the Conversion of NAB Capital Notes for Ordinary Shares is the conversion of a convertible interest.

154. Under subsection 130-60(3), a capital gain or capital loss made from converting a convertible interest is disregarded. Therefore, any capital gain or capital loss made by the Holders from CGT event C2 happening on Conversion is disregarded.

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

155. On Conversion, Subdivision 130-C applies so that the first element of the cost base and reduced cost base of each Ordinary Share acquired on Conversion is the pro-rata portion of the Holder's cost base and reduced cost base of their NAB Capital Notes at the time of Conversion (item 2 of the table in subsection 130-60(1)).

Acquisition time of Ordinary Shares on Conversion

156. Ordinary Shares acquired on Conversion are taken to be acquired when the conversion happens on the relevant conversion date (subsection 130-60(2)).

NAB Capital Notes that are Written Off – CGT implications

157. If the NAB Capital Notes are Written Off, the NAB Capital Notes do not Convert, and the rights attached to the NAB Capital Notes are immediately and irrevocably terminated.

158. CGT event C2 happens if a taxpayer's intangible CGT asset ends by the asset being redeemed, cancelled, released, discharged or satisfied (paragraphs 104-25(1)(a) and (b)). Therefore, CGT event C2 happens when the NAB Capital Notes are Written Off, because they are immediately and irrevocably terminated at that time.

159. For the purposes of determining whether the Holders make a capital gain or a capital loss from CGT event C2 happening in respect of their NAB Capital Notes, the Holders are taken to have nil capital proceeds from CGT event C2 happening.

160. The capital proceeds from a CGT event is the total of the money and the market value of any property that the taxpayer has received or is entitled to receive (section 116-20). The Holders do not receive any money or other property when their NAB Capital Notes are Written Off.

161. Where a taxpayer receives no capital proceeds from a CGT event, they are taken to have received the market value of the CGT asset that is the subject of the event (subsection 116-30(1)). However, when the NAB Capital Notes are Written Off because of a Non-Viability Event, they have a market value of nil at that time.

162. Therefore, CGT event C2 happens for the Holders on their NAB Capital Notes being Written Off, and the Holders are taken to have nil capital proceeds in respect of CGT event C2 happening.

Issue of Ordinary Shares on Conversion not a dividend or a non-share dividend

163. The issue of Ordinary Shares on Conversion is a distribution of property to holders of a non-share equity interest and a non-share distribution under subparagraph 974-115(b)(ii). A non-share distribution is a non-share dividend, but not to the extent the company debits the distribution against its share capital account or non-share capital account.

164. On Conversion, NAB debits the Face Value of the NAB Capital Notes to its non-share capital account. Accordingly, the issue of Ordinary Shares on Conversion is not a non-share dividend and is not included in the Holders assessable income under subparagraph 44(1)(a)(ii) of the ITAA 1936.

Application of sections 45, 45A and 45B of the ITAA 1936

165. The NAB Capital Notes are non-share equity interests as defined in subsection 995-1(1) and the Holders are ‘equity holders’ as defined in subsection 995-1(1). Paragraph 43B(1)(a) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 (which includes sections 45, 45A and 45B of the ITAA 1936) applies to a non-share equity interest in the same way as it applies to a share. Paragraph 43B(1)(b) of the ITAA 1936 provides that Subdivision D of Division 2 of Part III of the ITAA 1936 applies to an equity holder in the same way as it applies to a shareholder.

Section 45 of the ITAA 1936

166. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some (but not all) shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

167. NAB has consistently paid fully franked dividends/distributions on its ordinary shares and other hybrid instruments in recent years (to the extent such dividends/distributions are frankable). Distributions paid on NAB ordinary shares, and other hybrid instruments such as the Capital Notes are expected to be fully franked. However, franking is not guaranteed.

168. Furthermore, the Terms do not allow NAB to issue Ordinary Shares to some or all of the Holders as an alternative to the payment of Distributions.

169. Therefore, section 45 of the ITAA 1936 does not apply to treat the value of Ordinary Shares issued on Conversion as an unfrankable dividend paid by NAB to the Holders.

Section 45A of the ITAA 1936

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

171. If these conditions are satisfied, the Commissioner may make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat all or part of the capital benefit as an unfranked dividend, so that it can be included in the assessable income of the advantaged shareholders.

172. The issue of Ordinary Shares to the Holders on the Conversion of the NAB Capital Notes is a 'provision of a capital benefit' to the Holders (as defined in paragraph 45A(3)(a) of the ITAA 1936).

173. In the absence of any other factors, the issue of Ordinary Shares on Conversion is not considered to be streaming the provision of capital benefits.

174. Redemption involves the provision of capital benefits within the meaning of subsection 45A(3) of the ITAA 1936 as it is a non-share capital return (subsection 45A(3A) of the ITAA 1936). The amount paid to the Holders on Redemption is limited to the amount of the Face Value of each NAB Capital Note, and any Distribution entitlements on the NAB Capital Notes are separately paid as Distributions, given that a Redemption Date will also be a Distribution Payment Date under the Terms.

175. Accordingly, it cannot be said that the Holders derive a greater benefit from the capital benefits than other NAB shareholders. Therefore, the Redemption or the issue of Ordinary Shares on Conversion of the NAB Capital Notes will not trigger the application of section 45A of the ITAA 1936. Accordingly, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 in respect of the Conversion or Redemption of NAB Capital Notes.

Section 45B of the ITAA 1936

176. 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. Paragraph 45B(3)(b) of the ITAA 1936 empowers the Commissioner to make a determination that all or part of the capital benefit is to be treated as an unfranked dividend, so that it can be included in the assessable income of the relevant taxpayer.

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

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

178. The issue of Ordinary Shares to Holders on Conversion is a scheme under which the Holders are provided with a capital benefit by NAB (paragraph 45B(5)(a) of the ITAA 1936). Similarly, Redemption also constitutes a scheme under which the Holders are provided with a capital benefit by NAB (paragraph 45B(5)(b) of the ITAA 1936 by virtue of subsection 45B(7) of the ITAA 1936).

179. 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.

180. Having regard to the relevant circumstances surrounding the issue of Ordinary Shares on Conversion, it cannot be concluded that NAB, the Holders, or any other person, intend to enter into or carry out the Conversion of NAB Capital Notes into Ordinary Shares for the purpose of enabling the Holders to obtain a capital benefit.

181. Similarly, it cannot be said that Redemption involves 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 NAB Capital Notes and any Distribution entitlements on NAB Capital Notes are separately paid as a Distribution, given that a Redemption Date will also be a Distribution Payment Date under the Terms.

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

Amendment of the Terms to substitute an Approved NOHC

183. If an Approved NOHC becomes the ultimate holding company of NAB, NAB may give a notice to the Holders specifying the amendments that will be made to the Terms so as to ensure that, upon the Conversion of the NAB Capital Notes, ordinary shares in the Approved NOHC will be issued to the Holders instead of NAB ordinary shares.

184. CGT event H2 (section 104-155) happens when an act, transaction or event occurs in relation to a CGT asset that an entity owns, and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.

185. The amendment of the Terms to effect the substitution of an Approved NOHC as the issuer of ordinary shares to the Holders on the Conversion of the NAB Capital Notes would be an act, transaction or event that occurs in relation to the NAB Capital Notes. As amendment of the Terms does not result in an adjustment to the cost base or reduced cost base of the NAB Capital Notes, CGT event H2 happens when the Terms are amended.

186. Subsection 116-20(2) provides that the capital proceeds from CGT event H2 is the money or other consideration an entity received, or is entitled to receive, because of the act, transaction or event that is the subject of CGT event H2.

187. There are no capital proceeds because of CGT event H2 happening as a result of the amendment of the Terms. There are no incidental costs incurred by Holders that relate to the amendment of the Terms. Accordingly, the Holders do not make a capital gain or a capital loss from CGT event H2 happening on the amendment of the Terms.

188. No other CGT event happens because of the amendment of the Terms.

Conversion of each NAB Capital Note and the issue of ordinary shares in an Approved NOHC – CGT implications

189. CGT event C2 (section 104-25) happens if an entity's ownership of an intangible CGT asset that is a convertible interest ends by the asset being converted (paragraph 104-25(1)(f)).

190. If an Approved NOHC is the ultimate holding company of NAB, the Conversion of the NAB Capital Notes involves the issue of Approved NOHC ordinary shares to the Holders, which is a conversion of a convertible interest. Therefore, CGT event C2 happens.

191. A capital gain or capital loss that a Holder makes from CGT event C2 happening, where the conversion of the NAB Capital Notes involves the issue of Approved NOHC ordinary shares to the Holders, is disregarded under subsection 130-60(3).

192. If the Approved NOHC ordinary shares are not equity interests in the Approved NOHC under Division 974, each NAB Capital Note is not a convertible interest in NAB. As a result, subsection 130-60(3) would not apply to disregard the capital gain or capital loss that the Holders make from CGT event C2 happening.

Cost base of the Approved NOHC ordinary shares

193. Under item 2 of the table in subsection 130-60(1), the first element of the cost base and the reduced cost base of each Approved NOHC ordinary share issued to the Holders is calculated as the cost base of their NAB Capital Notes at the time of the conversion divided by the number of Approved NOHC ordinary shares they receive.

Acquisition time of the Approved NOHC ordinary shares

194. The Holders will be taken to have acquired the Approved NOHC ordinary shares at the time of the conversion of the NAB Capital Notes (subsection 130-60(2)). This means that when determining a Holder's eligibility to make a discount capital gain from a CGT event happening to the Approved NOHC ordinary shares, the 12 month period will start from the day after the acquisition date of the Approved NOHC ordinary shares (Taxation Determination TD 2002/10) and not from the acquisition date of the NAB Capital Notes.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/14; TR 2006/10;
TD 2002/10; TD 2007/29

Subject references:

- acquisition dates
- capital gains tax
- CGT cost base
- conversion of securities
- dividend imputation
- dividend income
- dividend streaming
- arrangements
- franking tax offset

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 26BB
- ITAA 1936 26BB(1)
- ITAA 1936 26BB(2)
- ITAA 1936 26C
- ITAA 1936 Pt III Div 2 Subdiv D
- ITAA 1936 43B(1)(a)
- ITAA 1936 43B(1)(b)
- ITAA 1936 44(1)
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- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(2)
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- ITAA 1936 45B
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- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
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- ITAA 1936 45B(5)(a)
- ITAA 1936 45B(5)(b)
- ITAA 1936 45B(7)
- ITAA 1936 45B(8)
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- ITAA 1936 177EA(12)(a)
- ITAA 1936 177EA(17)
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- ITAA 1997
- ITAA 1997 Div 67
- ITAA 1997 67-25
- ITAA 1997 67-25(1C)
- ITAA 1997 67-25(1D)
- ITAA 1997 Div 104
- ITAA 1997 104-25
- ITAA 1997 104-25(1)(a)
- ITAA 1997 104-25(1)(b)
- ITAA 1997 104-25(1)(f)
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- ITAA 1997 110-25
- ITAA 1997 110-25(2)
- ITAA 1997 110-25(2)(a)
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- ITAA 1997 110-55(2)
- ITAA 1997 116-20
- ITAA 1997 116-20(2)
- ITAA 1997 116-30(1)
- ITAA 1997 Subdiv 130-C
- ITAA 1997 130-60(1)
- ITAA 1997 130-60(2)
- ITAA 1997 130-60(3)
- ITAA 1997 Div 197
- ITAA 1997 202-40
- ITAA 1997 Div 203
- ITAA 1997 Subdiv 204-D
- ITAA 1997 204-30
- ITAA 1997 204-30(1)(a)
- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)

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- ITAA 1997 207-145
- ITAA 1997 207-145(1)
- ITAA 1997 207-145(1)(a)
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- ITAA 1997 207-155
- ITAA 1997 215-20
- ITAA 1997 Div 230
- ITAA 1997 960-120
- ITAA 1997 Div 974
- ITAA 1997 974-75
- ITAA 1997 974-75(1)
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- ITAA 1997 974-120
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- ITAA 1997 974-165(b)(i)
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Other references:

- Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002

ATO references

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