



Determination S5: Issue of TCNZ Finance Limited Convertible Capital Notes Denominated in New Zealand Dollars Convertible at the Option of the Issuer – Amounts Attributable to an Excepted Financial Arrangement where TCNZ Finance Limited Convertible Capital Notes are Redeemed for Shares

This determination may be cited as “Determination S5: Issue of TCNZ Finance Limited Convertible Capital Notes Denominated in New Zealand Dollars Convertible at the Option of the Issuer – Amounts Attributable to an Excepted Financial Arrangement where TCNZ Finance Limited Convertible Capital Notes are Redeemed for Shares”.

1. Explanation: (which does not form part of the determination)

(1) The Capital Notes, to be issued by TCNZ Finance on the terms and conditions set out in Schedule 2 to the Capital Notes Trust Deed, constitute a financial arrangement or series of financial arrangements.

(2) Each Capital Note evidences that the Noteholder has provided money to TCNZ Finance. Subject to the terms of the Capital Note, this money is repayable at a future date in either cash or Telecom Shares. Where Capital Notes are redeemed by an issue of Telecom Shares, the number of shares issued will be calculated in accordance with Schedule 2 to the Capital Notes Trust Deed. Coupon Interest Payments may be made between the date of the issue of each Capital Note and the redemption date.

(3) Each Capital Note has a debt and an equity component. The equity component is the option for TCNZ Finance to redeem the Capital Note by procuring the issue of Telecom Shares.

(4) Pursuant to section EH 2 of the Income Tax Act 1994, the amount of the gross income deemed to be derived or the expenditure deemed to be incurred by a person in respect of a financial arrangement under the qualified accruals rules shall not include the amount of any income, gain or loss, or expenditure that is solely attributable to an excepted financial arrangement that is part of the financial arrangement.

(5) This determination sets out the method for determining the amount of any income, gain or loss, or expenditure, in relation to each Capital Note that is solely attributable to the excepted financial arrangement (the equity) component of the Capital Note. In particular, where Capital Notes are converted into, redeemed or paid by the issue or delivery of, Telecom Shares, the income, gain or loss, or expenditure that is solely attributable to the excepted financial arrangement component of the Capital Notes equals any amount by which the value of the Telecom Shares is above, or below (as the case may be) the Cash Redemption Amount of the Capital Notes that are redeemed for Telecom Shares.

(6) The amount of any gross income, or expenditure for any Capital Note under the qualified accruals rules is therefore the same whether the Capital Note is redeemed for Telecom Shares or for cash.

(7) This determination does not deal with the spreading of accrual income or expenditure under the qualified accruals rules in relation to the issuing and holding of



the Capital Notes. In this regard reference should be made to section EH 1 of the Income Tax Act 1994.

2. Reference:

(1) This determination is made pursuant to section 90(1)(g) of the Tax Administration Act 1994.

(2) “Determination G5C: Mandatory Conversion Convertible Notes” does not apply to the Capital Notes because it only applies to mandatory conversion convertible notes. The Capital Notes are not mandatory convertible notes. “Determination G22: Optional Conversion Convertible Notes Denominated in New Zealand Dollars Convertible at the Option of the Holder” does not apply to the Capital Notes. The Capital Notes are convertible at the option of the issuer.

3. Scope of Determination:

(1) This determination shall apply to the Capital Notes issued by TCNZ Finance on the terms and conditions set out in Schedule 2 to the Capital Notes Trust Deed, to the extent that such Capital Notes are denominated in New Zealand dollars, where:

- (a) The Capital Notes are subordinated to all TCNZ Finance’s senior debt and trade creditors, but rank ahead of its ordinary shares.
- (b) Noteholders do not benefit from any capital growth in Telecom’s shares and do not participate in any dividends, or any other distributions made in respect of those shares. No voting rights (in TCNZ Finance or Telecom) attach to the Capital Notes.
- (c) Capital Notes will be issued with an election date for redemption of up to 15 years, and not less than four years, from the relevant date of issue.
- (d) Prior to each election date Noteholders may elect to retain some or all of their Capital Notes for a further period on new terms and conditions as determined by TCNZ Finance, or to redeem some or all of their Capital Notes. Subject to being solvent (in the opinion of its directors) TCNZ Finance has the option as to whether to redeem the Capital Notes for cash or Telecom Shares. In the event that TCNZ Finance elects to redeem any of the Capital Notes for Telecom Shares, TCNZ Finance will procure the issue by Telecom of such number (fractions being rounded to the next whole number) of Telecom Shares as are equal in value to the Cash Redemption Amount of the Capital Notes which are being redeemed by the issue of Telecom Shares. The value in such a case means 90% of the average market price of Telecom Shares on the NZSE, as more particularly determined in accordance with clause 8.2(b) of Schedule 2 to the Capital Notes Trust Deed.
- (e) The 10% discount to the current average market price at the time of issue of the Telecom Shares, as described in paragraph 3(1)(e) of this determination, only relates to the discount to current market price that may occur if Noteholders sought to realise cash by selling such Telecom Shares. In particular, the intention of the



discount is that the Noteholder suffers no detriment from any election by TCNZ Finance to redeem the Capital Notes for Telecom Shares due to the costs of having to exchange such shares for cash, and the risk that large scale selling of Telecom Shares on the market at that time will put downward pressure on the Telecom Share price.

- (f) To the extent that any Capital Note is redeemed for Telecom Shares, the decision that TCNZ Finance will elect to redeem such Capital Note for Telecom Shares (as opposed to cash) will not be as a result of any contract, agreement, plan or understanding (whether enforceable or unenforceable) between TCNZ Finance and / or Telecom and any other person to provide a further return or further benefit to that Noteholder.
 - (g) Irrespective of any election by a Noteholder, TCNZ Finance may (at its option and on a non-pro-rata basis) purchase or redeem some or all of the Capital Notes for cash.
 - (h) If TCNZ Finance cannot redeem the Capital Notes for cash or Telecom Shares because it would, in the opinion of its directors, not be solvent if it did so, then the election date is reset for a period not exceeding two years. If TCNZ Finance is still unable to redeem the Capital Notes for the same reason, then the Trustee of the Capital Notes is entitled to apply to appoint a liquidator.
 - (i) If TCNZ Finance cannot redeem the Capital Notes for Telecom Shares (because Telecom cannot lawfully issue the shares, or the shares are no longer listed on the NZSE, or TCNZ Finance cannot lawfully subscribe for the shares) then the election date is reset for a period not exceeding two years. If TCNZ Finance is still unable to redeem the Capital Notes for Telecom Shares (for any of the stated reasons) another election date is set, again for a period not exceeding two years.
 - (j) During the period between issue and the relevant election date, each Capital Note will bear interest at a prescribed fixed rate determined as at the time the issue is priced by reference to the relevant government stock yield rate and being at the time the issue is priced no more than 50 basis points above the rate at which TCNZ Finance could issue a similar volume of senior fixed rate bonds with a maturity equivalent to the term until the initial election date for redemption of that Capital Note and being no less than such senior fixed rate bond rate. Interest is payable six-monthly. Unpaid interest bears interest itself and is compounded on each subsequent date for payment of interest.
- (2) This determination does not deal with the spreading of accrual income or expenditure under the qualified accruals rules in relation to how those rules apply to the issuing and holding of the Capital Notes.
- (3) For the avoidance of doubt, this determination also does not deal in any respect with the manner in which the number, or value, of Telecom Shares issued, in the event that any Capital Note is redeemed for Telecom Shares, is actually calculated. In this regard, reference should be made to Schedule 2 to the Capital Notes Trust Deed. (A copy of the Capital Notes Trust Deed is available for inspection on the public file



at the Commercial Affairs Division, Ministry of Commerce, 47 Boulcott Street, Wellington, or at the registered office of TCNZ Finance, Telecom Networks House, 68 Jervois Quay, Wellington, or Registry Managers (New Zealand) Limited, Level 3, 277 Broadway, Newmarket, Auckland, or The Trustees Executors and Agency Company of New Zealand Limited, Trustees Executors House, 169 The Terrace, Wellington.)

4. Principle:

(1) The Capital Note is a hybrid financial arrangement which has a debt and an equity component. The equity component is the option available to TCNZ Finance to procure the issue of Telecom Shares to Noteholders in lieu of payment in cash of the Cash Redemption Amount.

(2) Any income, gain or loss, or expenditure that is solely attributable to an excepted financial arrangement is not included when calculating gross income or expenditure under the qualified accruals rules.

(3) The effect of this determination is that income and expenditure under the qualified accruals rules will be calculated, in respect of both the Noteholder of the Capital Note and TCNZ Finance, on the basis that only the difference between the value of the Telecom Shares received by the Noteholder and the Cash Redemption Amount is solely attributable to the excepted financial arrangement.

5. Interpretation:

In this determination (and the Explanation), unless the context otherwise requires –

Words and expressions used shall have the same meaning as in the Act, except that where there is a conflict between the meaning of an expression used in the qualified accruals rules as defined in section OZ 1 of the Act, and the meaning of the expression elsewhere in the Act, the expression shall have the meaning as in the said qualified accruals rules.

“the Act” means the Income Tax Act 1994.

“Capital Note” or “Capital Notes” means the capital note or capital notes issued by TCNZ Finance on the terms and conditions set out in Schedule 2 to the Capital Notes Trust Deed.

“Capital Notes Trust Deed” means the trust deed between TCNZ Finance and The Trustees Executors and Agency Company of New Zealand Limited dated 22 April 1997.

“Cash Redemption Amount”, in respect of Capital Notes to be redeemed by the issue of Telecom Shares, means the cash amount that, according to the terms of the Capital Notes, the Noteholder of those Capital Notes would receive upon the redemption for cash of the Capital Notes (such amount being the same as the aggregate of the



“Redemption Amount” as defined in Schedule 2 to the Capital Notes Trust Deed for those Capital Notes).

“Coupon Interest Payment” or “Coupon Interest Payments” in respect of a Capital Note means any cash amount or amounts paid on the Capital Note by TCNZ Finance to or on behalf of the Noteholder, other than the Cash Redemption Amount.

“Noteholder or Noteholders” means a person or persons investing in a Capital Note or Capital Notes.

“TCNZ Finance” means TCNZ Finance Limited.

“Telecom” means Telecom Corporation of New Zealand Limited.

“Telecom Shares” means ordinary shares issued by Telecom.

6. Method:

(1) Where any Capital Notes are converted into, redeemed or paid by the issue or delivery of Telecom Shares, the income, gain or loss, or expenditure that is solely attributable to the excepted financial arrangement component of such Capital Notes equals any amount by which the aggregate market value of the number of Telecom Shares issued on redemption of those Capital Notes (the number of shares issued being determined in the manner described at paragraph 3(1)(e) of this determination) is above, or below, (as the case may be) the Cash Redemption Amount for those Capital Notes.

(2) For the purposes of the base price adjustment the amount of the acquisition price of each Capital Note shall be determined in accordance with the acquisition price definition as provided in section OB 1 of the Act with no part of the core acquisition price being attributable to the excepted financial arrangement component of that Capital Note.

(3) No part of the Coupon Interest Payments are attributable to the excepted financial arrangement component of any Capital Note.

7. Examples:

Any reference in the following examples to the quantum of any Cash Redemption Amount and the value of Telecom Shares issued is illustrative only.

Example 1

Investor A notifies TCNZ Finance that Investor A wishes to redeem \$5,000 of Capital Notes.

TCNZ Finance elects to redeem the Capital Notes by procuring the issue of Telecom Shares rather than for cash. The Capital Notes to be redeemed for Telecom Shares



have a Cash Redemption Amount of \$5,400 (being the principal amount of the Capital Notes (\$5,000) and accrued interest, less any withholding taxes (\$400)).

Investor A receives Telecom Shares in accordance with the formula prescribed in Schedule 2 of the Capital Notes Trust Deed. For the purposes of this example those shares are assumed to have a market value of \$5,600 on the date that the Capital Notes are redeemed.

In accordance with the method prescribed in paragraph 6 of this determination, for both Investor A and for TCNZ Finance, the amount solely attributable to the excepted financial arrangement is:

\$5,600 (being the market value of the shares) - \$5,400 (being the Cash Redemption Amount) = \$200 (being the amount solely attributable to the excepted financial arrangement).

Therefore, where TCNZ Finance elects to redeem the Capital Notes by procuring the issue of Telecom Shares, the result for both TCNZ Finance and Investor A is that the relevant amount required to be included in calculating the gross income, or expenditure for the purposes of the qualified accruals rules, is the Cash Redemption Amount.

Example 2

Investor B notifies TCNZ Finance that Investor B wishes to redeem \$5,000 of Capital Notes.

Of the \$5,000 Capital Notes to be redeemed, TCNZ Finance elects to redeem \$2,000 of the Capital Notes by procuring the issue of Telecom Shares rather than for cash. The Capital Notes to be redeemed for Telecom Shares have a Cash Redemption Amount of \$2,200 (being the principal amount of those Capital Notes (\$2,000) and accrued interest, less any withholding taxes, in respect of those Capital Notes (\$200)).

Investor B receives Telecom Shares in accordance with the formula prescribed in Schedule 2 of the Capital Notes Trust Deed. For the purposes of this example those shares are assumed to have a market value of \$2,300 on the date that the Capital Notes are redeemed.

In accordance with the method prescribed in paragraph 6 of this determination, for both Investor B and for TCNZ Finance, the amount solely attributable to the excepted financial arrangement is:

\$2,300 (being the market value of the shares) - \$2,200 (being the Cash Redemption Amount) = \$100 (being the amount solely attributable to the excepted financial arrangement).

Therefore, where TCNZ Finance elects to redeem some of the Capital Notes by procuring the issue of Telecom Shares, the result for both TCNZ Finance and Investor B is that the relevant amount required to be included in calculating the gross income,



or expenditure for the purposes of the qualified accruals rules in respect of those Capital Notes redeemed for Telecom Shares, is the Cash Redemption Amount.

This determination is signed by me on the 12th day of May 1997.

Martin Smith

General Manager (Adjudication & Rulings)