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Determination S9: Issue of NZ Co Converting Notes Denominated in Australian Dollars

This determination may be cited as "Determination S9: Issue of NZ Co Converting Notes Denominated in Australian Dollars".

Explanation (which does not form part of the determination)

1. This determination relates to converting notes ("the Notes") issued by NZ Co, a wholly owned New Zealand subsidiary of Parent Co, to the Noteholder to evidence that the Noteholder has provided money to NZ Co.

2. The Notes constitute financial arrangements issued pursuant to an Information Memorandum For the Issue and Private Placement of Converting Notes by NZ Co Denominated in Australian Dollars dated 17 March 1998. Each Note forms part of a wider financial arrangement comprising the Note and agreement to purchase shares in Parent Co, and the subsequent purchase of the shares.

3. Subject to the terms of the Note, the money lent by the Noteholder is to be payable at a future date in cash. Noteholders have an obligation to purchase shares with the Redemption Proceeds in Parent Co, a company listed on a recognised stock exchange, unless NZ Co chooses not to enforce the obligation. If Noteholders are required to purchase shares in Parent Co, the Notes will be redeemed by NZ Co for Face Value and the shares will be issued by Parent Co at a five percent discount. If Noteholders are not required to purchase shares with the Redemption Proceeds, the Notes will be redeemed for Face Value and five percent additional interest. Prior to Maturity, on the happening of a conversion event, Noteholders can choose to redeem their Notes and purchase shares in Parent Co. Coupon Interest at a fixed rate will be paid in the period between the issue of the Notes and their redemption.

4. Each wider financial arrangement has both a debt component, and equity components which are "excepted financial arrangements" as defined in section OB 1 of the Income Tax Act 1994. The equity components that are excepted financial arrangements are:

   - the option for the Noteholder to acquire shares in Parent Co on the happening of a conversion event prior to Maturity by redeeming the Notes and using the Redemption Proceeds to purchase the shares; and

   - the shares in Parent Co.

5. The amount of gross income deemed to be derived or expenditure deemed to be incurred by a person under the qualified accrual rules in respect of a financial arrangement excludes any amount of income, gain or loss, or expenditure that is solely attributable to an excepted financial arrangement.

6. This determination prescribes a method to be used when calculating for accrual purposes, the gross income derived or expenditure incurred in respect of the Notes.

Reference

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

2. Determination G5C does not apply to the Notes as the Notes are not Mandatory Conversion Convertible Notes. Determination G22 does not apply as the Notes are denominated in Australian dollars.

Scope of Determination

1. This determination applies specifically to the Notes issued pursuant to an Information Memorandum For the Issue and Private Placement of Converting Notes by NZ Co Denominated in Australian Dollars dated 17 March 1998, where:

   (a) The Notes will be unsecured but guaranteed by Parent Co. The guarantee is subordinated to the rights of other commercial debtholders, but will rank pari passu with Parent Co's obligations to any other Noteholders the company has.

   (b) Noteholders do not participate in any dividends or any other distributions made in respect of shares. The Notes carry no voting rights.

   (c) The Notes carry a fixed coupon (semi-annual) rate of interest. The rate is to be set by reference to the five-year swap bid rate as published on AFMA page 45,402 at the date of issue, and the spread will take account of the rating of Parent Co by Standard & Poors at the time of issue, the subordinated nature of the Notes and the uncertainty over the ownership of the guarantor. The interest rate on the Notes is set on a stand alone basis having regard to the terms of the Notes alone, and without reference to the shares in Parent Co. Pursuant to the guarantee by Parent Co, NZ Co will suspend the Coupon Interest where Parent Co does not declare a dividend for a half-year period. Any suspension of the Coupon Interest is non-cumulative.

   (d) The Notes are issued with mandatory "conversion" at the end of five years from the anniversary of the issue. At various times (on the happening of a conversion event) from the end of the third year to the end of the fifth year from the date of issue, the Noteholder has the option to convert the Note into ordinary shares in Parent Co. NZ Co has the option at maturity to redeem the Notes for cash rather than convert to shares.

   (e) The mechanism by which Notes are "converted" is NZ Co will redeem the Notes in cash for their Face Value and the Noteholder is obliged to use those Redemption Proceeds to acquire shares in Parent Co.

   (f) The Noteholder will receive shares in Parent Co at a five percent discount to the market price at the date of conversion (subject to a minimum conversion price of A$0.25 which equals the par value of the shares). The five percent discount is in recognition that the Noteholder holds a debt instrument and would likely wish to immediately realise the shares acquired. The various transaction costs associated with share realisation and the risks of downward share price movement on large scale share sales, require that the Noteholder be compensated to ensure the Noteholder is in the same position had it simply received cash equal to the face value of the debt. The five percent discount on the market price is to ensure the Noteholder can in essence realise the equivalent of the face value of the debt on liquidating its position in Parent Co.

(g) The Noteholder also has a right to elect to convert the Notes and receive a maximum of 6 months' interest (or "Termination Fee") in the event interest is suspended (as outlined in paragraph (c) above). Additional rights of conversion are available in certain circumstances (such as in certain exceptional default events such as Parent Co delisting, issue of a bonus issue by Parent Co, or on an announcement of a takeover).

(h) At maturity of the Note, rather than requiring the Noteholders to purchase shares in Parent Co, NZ Co may elect to redeem the Notes at their Face Value plus an amount of Additional Interest equal to five percent of the Face Value. Under this cash redemption option, NZ Co will pay the Noteholder and the amount of Additional Interest will be reimbursed to NZ Co by Parent Co or one of its subsidiaries.

(i) In the event of a change in control of Parent Co, NZ Co may also elect to redeem the Notes for the Cash Redemption Amount.

Principle

(1) The Note forms part of a wider financial arrangement which has both a debt component, and equity components that are "excepted financial arrangements" as defined in section OB 1 of the Income Tax Act 1994. The equity components that are excepted financial arrangements are:

- the option for the Noteholder to acquire shares in Parent Co on the happening of a conversion event prior to Maturity by redeeming the notes and using the Redemption Proceeds to purchase the shares; and

- the shares in Parent Co.

The option that NZ Co has to require the Noteholders to use the Redemption Proceeds to purchase shares in Parent Co does not satisfy the definition of "excepted financial arrangement".

(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 accrual rules.

(3) This determination specifies that no amounts are attributable to the excepted financial arrangements.

Interpretation

1. In this determination, the following expressions (which have not been defined elsewhere within the determination) have the following meanings:

"Additional Interest"	means five percent of the Face Value of the Note.
"Cash Redemption Amount"	means the cash amount expressed in Australian dollars being the amount which the Noteholder would receive upon the exercise by NZ Co of the right to redeem the Notes in cash, being the Face Value plus Additional Interest but excluding any Coupon Interest.
"Coupon Interest"	means the cash interest amounts paid on a semi-annual basis by NZ Co to the Noteholder.
"Face Value"	means the amount of money provided to NZ Co as evidenced by the Note.
"NZ Co"	means NZ Co, a company incorporated in New Zealand.
"Parent Co"	means Parent Co, a public company listed on a recognised stock exchange.
"Maturity"	means five years from the date of issue of the Notes.
"Note"	means the Converting Note issued by NZ Co pursuant to a poll deed.
"Noteholder"	means a person or persons investing in the Notes.
"Redemption Proceeds"	means the cash amount expressed in Australian dollars, being the amount which the Noteholder receives upon the Notes being redeemed which must then be used to purchase shares in Parent Co.
"Termination Fee"	means the interest payable (up to a maximum of 6 months) where the Noteholders elect to convert the Notes into shares following an interest suspension.

Method

1. No part of the following amounts are attributable to the excepted financial arrangements:

   - Where the Noteholder uses the Redemption Amounts to subscribe for Parent Co shares, the amount by which the aggregate market value of the Parent Co shares (expressed in Australian dollars in which the Notes are denominated) is above the Face Value of the Notes held by that Noteholder and redeemed by NZ Co.
   - The Coupon Interest payments.
   - The Additional Interest.

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- The Termination Fee.

Examples

(Any reference to the redemption amount or value of Parent Co shares is illustrative only.)

Example 1

Investor A has A$10,000 of Notes issued by NZ Co, and on 15 September in Year 4 elects to convert the Notes to shares in Parent Co.

Accrued Coupon Interest of A$200 to the date of conversion is paid to Investor A in cash.

The market price of Parent Co shares at the date of conversion is $2.63. The conversion price is A$2.50 [i.e. A$2.63 x 0.95 (rounded to the nearest whole cent)]. Investor A is issued with 4,000 shares which have a total market value of A$10,520.

The Face Value of the Notes is A$10,000.

In accordance with the method prescribed in the determination, neither the Coupon Interest nor the $520 difference between the Face Value of the Notes and the value of the shares is attributable to the excepted financial arrangements.

Example 2

Investor B has A$10,000 of Notes issued by NZ Co, and at the end of Year 5 must convert the Notes to shares in Parent Co. NZ Co does not elect to redeem the Notes for cash at maturity.

The market price of Parent Co shares at the date of conversion is A$2.63. The conversion price is A$2.50. Investor B is issued with 4,000 shares which have a total market value of A$10,520.

Accrued Coupon Interest of A$500 to the date of maturity is paid to the Noteholder in cash.

The Face Value of the Notes is A$10,000. Investor B receives $10,520 worth of shares.

In accordance with the method prescribed in the determination, neither the Coupon Interest nor the $520 difference between the Face Value of the Notes and the value of the shares is attributable to the excepted financial arrangements.

Example 3

Investor C has A$10,000 of Notes issued by NZ Co, and at the end of Year 5 must convert the Notes to shares in Parent Co. NZ Co elects to redeem the Notes for cash at maturity.

The market price of Parent Co shares at the date of conversion is A$2.63. Investor C receives A$10,500 as the Cash Redemption Amount.

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NZ Co pays the Noteholder A$10,500 Cash Redemption Amount and the accrued Coupon Interest of A$450 to the date of maturity. NZ Co is then reimbursed for A$500 from Parent Co (being the amount of Additional Interest).

The Face Value of the Notes is A$10,000.

In accordance with the method prescribed in the determination, neither the Coupon Interest nor the additional interest is attributable to the excepted financial arrangements.

This determination is signed by me on the 3rd day of June 1998.

Martin Smith
General Manager (Adjudication & Rulings)