

PRODUCT RULING - BR Prd 09/02

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by BNZ Income Securities Limited ("BNZIS")

Taxation Laws

All legislative references are to the Income Tax Act 2007, unless otherwise stated.

This Ruling applies in respect of sections BG 1, CX 56(3) and GB 35.

The Arrangement to which this Ruling applies

The Arrangement involved the raising of capital by Bank of New Zealand ("BNZ") and National Australia Bank Limited ("NAB"). BNZIS issued perpetual non-cumulative shares ("BNZIS Shares") to members of the public ("BNZIS Shareholders"). BNZIS lent the proceeds raised from the issue to BNZ Income Management Limited ("BNZIM"). BNZIM invested the proceeds of that loan ("BNZIM Loan") in perpetual preference shares issued by BNZ ("BNZ Preference Shares"), and, in turn, BNZ used the proceeds for general corporate purposes.

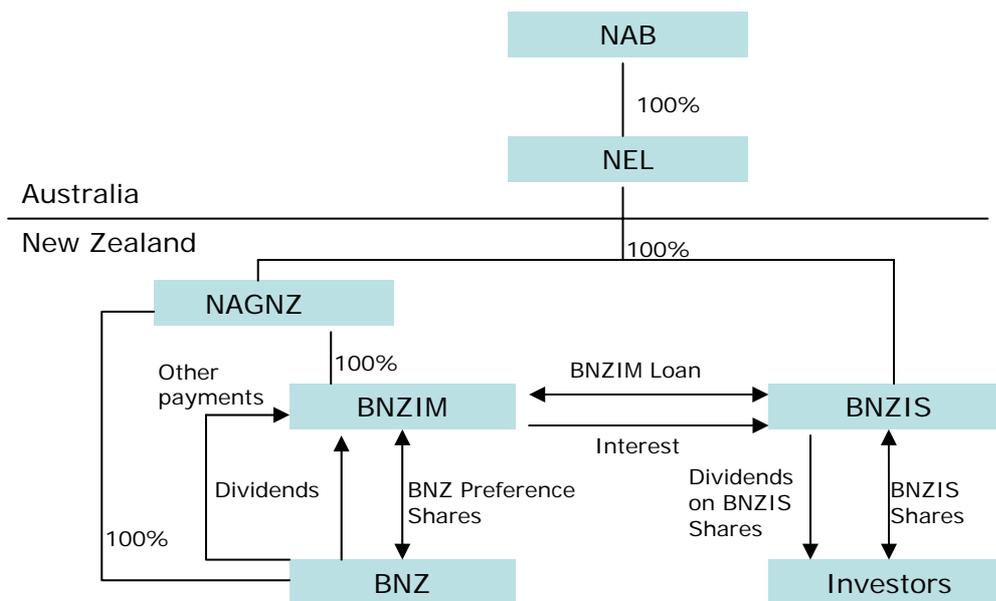
There was, at the time the Arrangement was entered into, and is no intention on the part of the Board of Directors of BNZ and/or NAB that the BNZ and/or NAB would promote the acquisition of BNZIS Shares by providing investors with a loan or other financing from any of the companies in the BNZ or NAB group.

This Ruling does not apply to any investor who or which has funded the acquisition of BNZIS Shares by means of borrowing or other financing from any of the companies in the BNZ or NAB group of companies, where such borrowing or other financing was part of an express agreement or arrangement (whether in writing or otherwise) with such entity that the proceeds of some or all of such borrowing or other financing would be used for the purposes of acquiring BNZIS Shares.

Further details of the Arrangement are set out in the paragraphs below.

1. The material terms of the transactions comprising the Arrangement are governed by the following documents (which were provided to Inland Revenue on either 11 April 2008 or 22 July 2008):
 - BNZIM Loan Agreement, dated 25 February 2008, between BNZIS and BNZIM;
 - BNZIS Deed Poll, dated 25 February 2008, entered into by BNZIS in favour of the BNZIS shareholders;

- Security Trust Deed, dated 25 February 2008, between BNZIM, BNZIS and New Zealand Permanent Trustees Limited;
 - Constitution of BNZ;
 - Constitution of BNZIS;
 - Committed Cash Advances Facility Agreement, between BNZ and BNZIS, dated 25 February 2008;
 - Administration Agreement, between BNZ and BNZIS, dated 25 February 2008.
2. Also provided to Inland Revenue on 11 April 2008 was a copy of the Combined Investment Statement and Prospectus regarding the Offer of Perpetual Non-cumulative Shares by BNZIS, dated 25 February 2008 (“Prospectus”).
 3. The Arrangement is summarised in the diagram below and discussed in subsequent paragraphs.



4. The Australian Prudential Regulatory Authority (“APRA”) currently treats the BNZIS Shares as innovative residual tier 1 capital for NAB on a level 2 basis. The Reserve Bank of New Zealand currently treats the BNZ Preference Shares as tier 1 capital for BNZ.

BNZIS

Incorporation of BNZIS

5. BNZIS is a special purpose company incorporated on 29 January 2008 under the Companies Act 1993 and intended to be tax resident solely in New Zealand. BNZIS was incorporated with 100 ordinary shares of \$1.00 each, all of which are held by National Equities Limited (“NEL”). NEL is a 100% subsidiary of NAB and is incorporated and tax resident in Australia. BNZIS subsequently issued a further 10,500,000 ordinary shares to NEL.

It issued a further tranche of 50,468 ordinary shares to NEL on 29 May 2008 to cover additional establishment costs in excess of the initial ordinary share issues.

6. The ordinary shares carry all of the voting rights in BNZIS but carry no right to a distribution in any circumstances.
7. Under the relevant accounting standards, BNZIS is a member of the NAB consolidated group ("NAB Group").

BNZIS Constitution

8. BNZIS has no power to carry on any business or activity other than that described in the BNZIS Constitution, which was lodged with the Companies Office on 25 February 2008.
9. Clause 4.1 of the BNZIS Constitution states:

Limitation on Business: The only business or activity which the Company may carry on is to:

- (a) issue and maintain in existence perpetual non-cumulative shares, including listing (and maintaining a listing of) those shares on any stock or securities exchange in New Zealand or elsewhere;
- (b) advance the proceeds of perpetual non-cumulative shares to BNZIM, or a Related Company of that company pursuant to one or more loan agreements;
- (c) enter into the Administration Agreement, the Committed Cash Advance Facility Agreement, the Security Trust Deed, the Loan Agreement, the Registration Agreement and the Deed Poll (and any other administration agreements, committed cash advance facility agreements, security trust deeds, loan agreements, registration agreements and/or deed polls in connection with the issue of perpetual non-cumulative shares);
- (d) do all other things reasonably incidental to the activities referred to in paragraphs (a), (b), (c) and this Constitution.

The Company has no power to:

- (e) carry on any other business or activity; or
- (f) apply amounts received by way of interest on, or repayment of, the loans referred to in paragraph (b) for any purpose other than in payments to the holders of the perpetual non-cumulative shares, meeting costs and expenses incurred in connection with the issuance and maintenance in existence of perpetual non-cumulative shares and making income and other tax payments to the New Zealand Inland Revenue Department.

10. BNZIS elected to be a portfolio investment entity ("PIE", as defined in section YA 1) with a commencement date of 28 March 2008.
11. Under the BNZIS Constitution, the directors of BNZIS are granted powers to take all steps considered necessary or desirable to ensure BNZIS continues to be eligible to be a PIE and qualify as a "portfolio listed company" ("PLC", as defined in section YA 1) under the requirements set out in the Act . These requirements include (but are not limited to):
 - rejecting applications for, or transfers of, BNZIS Shares (clauses 6.16 and 6.17 of the Constitution);
 - deeming any BNZIS Shares held that exceed the "investor interest size" requirements specified in the Act to be held by the BNZIS Shareholder on trust for any company in the NAB Group appointed by BNZIS and allowing such shares to be sold by that company (clause 6.17 of the Constitution);
 - allowing BNZIS to request any BNZIS Shareholder to provide such information as it may require to determine whether BNZIS continues to

meet the PLC requirements set out in the Act and, where holders do not provide such information within relevant periods, providing that the relevant BNZIS Shares are held on trust by the holder thereof for any company in the NAB Group appointed by BNZIS and allowing such shares to be sold by that company (clause 6.17 of the Constitution).

- taking any of the steps in clause 6.18 of the Constitution to ensure any breach of the “investor interest size” requirement is remedied within the period specified in the Act.

BNZIS Shares

12. BNZIS issued the BNZIS Shares under a public offer in New Zealand pursuant to the Prospectus referred to at paragraph 2. Clause 1.4 of the Prospectus states:

1.4 OFFER IN NEW ZEALAND ONLY

The Shares are being offered only to New Zealand residents and no offer is being made outside New Zealand. Accordingly, this Offer Document does not constitute an offer of the Shares in any jurisdiction other than New Zealand. No action has been or will be taken by BNZIS which would permit an offer of the Shares, or possession or distribution of any offering material, in any other country or jurisdiction where action for that purpose is required (other than New Zealand). The Shares may only be offered for sale or sold in conformity with all applicable laws and regulations in any jurisdiction in which they are offered, sold or delivered. No person may purchase, offer, sell, distribute or deliver any Shares, or have in its possession, publish, deliver or distribute to any person, any offering material or any documents in connection with the Shares, in any jurisdiction other than in compliance with all applicable laws and regulations.

Unless otherwise agreed with BNZIS, any person or entity applying for Shares is deemed to represent that they are not in a jurisdiction which prohibits the making of an offer of this kind and are not acting for a person in such a jurisdiction.

13. The public offer was of up to 350,000,000 BNZIS Shares at an issue price of \$1 per share, with the right to accept over-subscriptions of a further \$350,000,000. In total, 449,730,000 BNZIS Shares were issued pursuant to the offer, for a total subscription price of \$449,730,000. Of these shares, 5,000 (the minimum parcel) have been subscribed for and are held by NEL.
14. The offer of the BNZIS Shares to the public in New Zealand closed on 25 March 2008. The issue date of the BNZIS Shares was 28 March 2008, and the date of initial quotation and trading on the debt securities market (the “NZDX”) operated by New Zealand Exchange Limited (“NZX”) was 31 March 2008. Although the BNZIS Shares are not debt securities for the purposes of the Securities Act 1978, the NZX has given certain rulings on, and waivers of, the Listing Rules in relation to the listing of the BNZIS Shares on the NZDX. The BNZIS Shares are freely transferable, subject to certain ownership limitations.
15. The BNZIS Shares are perpetual, non-cumulative shares and have no fixed term, although the commercial expectation is that the funding raised by means of the issue of the BNZIS Shares will be in place for an initial five-year period, with extensions of further five-year periods, if desired. This is subject to potential exercise of the call option referred to in paragraph 45. The BNZIS Shares are not redeemable at the option of BNZIS or the BNZIS Shareholders, and in no circumstances will there be any conversion of the BNZIS Shares to ordinary shares.
16. The BNZIS Shares are non-voting shares, other than in respect of amendments that relate to the rights, privileges, limitations and conditions

attaching to them, meetings convened in relation to BNZIS's liquidation in certain circumstances and certain proceedings under the Security Trust Deed and the BNZIS Deed Poll (clause 6.22 of the BNZIS Constitution).

17. The BNZIS Shares (under clause 6.1 of the BNZIS Constitution) give BNZIS Shareholders the right to a quarterly dividend that is equal to a fixed percentage of the issue price per annum for the first five years as determined in accordance with the following formula:

$$\frac{\text{issue price} \times \text{dividend rate}}{4} \times (1-t)$$

18. The elements referred to in the formula in paragraph 17 are as set out below.

- (a) The issue price is \$1.
- (b) The dividend rate is the aggregate of the five-year swap rate (adjusted, as necessary, to a quarterly rate) and the margin (being 2.20%).
- (c) "t" is:
 - (i) for the period to the first dividend payment date (on 28 June 2008), 30%; and
 - (ii) otherwise, the weighted average basic rate of New Zealand income tax applicable to BNZIS during the period ending on the relevant quarterly dividend payment date.

19. At the expiry of the first five-year period, there will be a further five-year rate set by reference to the then applicable five-year swap rate, such rate setting to take place two business days before that expiry date (but with no change to the margin). The same process will apply at the end of the second and subsequent five-year periods.

20. On liquidation, the BNZIS Shares give the right to a pro rata share of any surplus after liquidation of BNZIS's assets and payment of its debts, in priority and to the exclusion of the holders of other classes of shares of BNZIS other than shares expressed to rank equally in liquidation of BNZIS.

21. The Prospectus states:

Cash to pay dividends on the Shares will be derived by BNZIS from interest it receives on its loan to BNZIM.

22. Payment of dividends on the BNZIS Shares will not occur if a Dividend Payment Condition occurs. Clause 6.5 of the BNZIS Constitution defines Dividend Payment Condition as any of the following conditions:

- (a) the Directors in their sole discretion do not resolve to pay the Dividend on the relevant Dividend Payment Date;
- (b) without limiting section 52(1) of the [Companies] Act [1993], the Directors are not satisfied on reasonable grounds that the Company will satisfy the solvency test (as defined in section 4 of the [Companies] Act [1993]) immediately after the payment of the Dividend;
- (c) unless APRA otherwise agrees:
 - (i) after payment of the Dividend (which for the purposes of this calculation includes both the Dividend Amount in respect of the relevant Dividend and an amount equal to the Imputation Credits to be attached to the Dividend on the basis that the Dividend is Fully Credited), the APRA Prudential Capital Ratio or the APRA Tier 1 Capital Ratio of the NAB Group (on an APRA Level 2 or, if applicable, APRA Level 3

basis) would cease to comply with APRA's then current capital adequacy guidelines, as they are applied to the NAB Group at the time; or

- (ii) the amount of the Dividend (which for the purposes of this calculation includes both the Dividend Amount in respect of the relevant Dividend and an amount equal to the Imputation Credits to be attached to the Dividend on the basis that the Dividend is Fully Credited) would exceed the Distributable Profits of the NAB Group as at the relevant Dividend Payment Date; or

(d) APRA otherwise objects to the payment of the Dividend by the Company.

- 23. Dividends paid on the BNZIS Shares will not be cumulative, and holders of the BNZIS Shares have no right to put BNZIS into liquidation for their non-payment (clause 6.6 of the BNZIS Constitution).
- 24. Many of the above features of the BNZIS Shares are required to ensure APRA treats the BNZIS Shares as innovative residual tier 1 capital for the NAB Group on a level 2 basis.
- 25. It is intended that the dividends will be fully imputed to the holders of the BNZIS Shares. Under the BNZIS Deed Poll, BNZIS covenants that, if it fails to fully impute dividends paid to the holders, it will compensate the holders for the additional tax cost incurred by the holders as a result of that failure. Clause 2 of the BNZIS Deed Poll states:

COVENANT TO PAY

BNZIS irrevocably covenants and agrees in favour of each Holder that, if BNZIS fails to attach sufficient Imputation Credits to any Dividend it pays on a Dividend Payment Date so that the Dividend is Fully Credited, then, subject to clause 3, it will pay to each Holder, within 10 Business Days of its receipt of the Holder's certificate, the amount that the Holder certifies in writing is necessary to compensate the Holder, on an after tax basis, for any additional tax cost the Holder suffers or incurs (or will suffer or incur) as a result of that failure, other than tax withheld by the Holder from a payment to another person.

BNZIM Loan

Details of the BNZIM Loan

- 26. BNZIS used the proceeds of the issue of the BNZIS Shares to make the BNZIM Loan to BNZIM. BNZIM is a company incorporated in New Zealand on 11 February 2008. BNZIM is expected to be resident for tax purposes in New Zealand. All of the shares in BNZIM are held by National Australia Group (NZ) Limited ("NAGNZ"), also a company incorporated in and tax resident in New Zealand. NAGNZ is the immediate holding company of BNZ and holds all of the ordinary shares issued in BNZ.
- 27. The BNZIM Loan is a perpetual loan (ie, it has no fixed maturity date). The principal amount of the BNZIM Loan is equal to the subscription amount for the BNZIS Shares. The BNZIM Loan is the only material asset of BNZIS and at least 90 percent of the income BNZIS derives will be interest from the BNZIM Loan.
- 28. Clause 4 of the BNZIM Loan Agreement provides that the BNZIM Loan pays interest quarterly. Interest is calculated in accordance with the following formula as defined in clause 1.1 of the Loan Agreement:

$$\frac{\text{loan amount} \times \text{interest rate}}{4}$$

- 29. The interest rate is the aggregate of the five-year swap rate (adjusted, as necessary, to a quarterly rate) plus the margin (being 2.20%).

30. At the expiry of the first five-year period, there will be a further five-year rate set by reference to the then applicable five-year swap rate, such rate setting to take place two business days before that expiry date (but with no change to the margin). The same process will apply at the end of the second and subsequent five-year periods.
31. The terms of the BNZIM Loan also oblige BNZIM to pay ongoing expenses incurred by BNZIS (such as expenses for services provided to it by BNZ or its auditors, and any net interest on short-term funding arrangements between it and BNZ).
32. Under clause 4.3 of the BNZIM Loan Agreement, interest on the BNZIM Loan will not be payable in respect of a quarterly interest period if an Interest Payment Condition applies. These conditions are if:
 - payment of the corresponding dividend by BNZIS would breach certain APRA requirements or exceed the NAB Group's distributable profits;
 - the payment of the interest would result in BNZIM failing to satisfy the solvency test under the Companies Act 1993;
 - the directors of BNZIS would not be satisfied on reasonable grounds that BNZIS would satisfy the solvency test under the Companies Act 1993 immediately on payment of the corresponding dividend by BNZIS; or
 - APRA otherwise objects to BNZIS making the corresponding dividend payment.
33. If and to the extent that all or any part of any interest on the BNZIM Loan is not paid because any of the above Interest Payment Conditions apply, BNZIM shall have no obligation to pay interest in respect of the relevant interest period and BNZIS's right to such amount will be cancelled.
34. As with the dividends on the BNZIS Shares, interest on the BNZIM Loan is not cumulative.
35. BNZIM invested the proceeds of the BNZIM Loan in BNZ Preference Shares (see paragraph 42). Because dividends on the BNZ Preference Shares will be paid on an after-tax basis, BNZIM will have a cash shortfall and will require additional funds to meet the interest payments on the BNZIM Loan. It is proposed that this cash shortfall be funded primarily by way of BNZ (or other profit-making companies in the BNZ group) making cash payments to BNZIM in exchange for loss-offset elections.

Repayment of BNZIM Loan

36. The BNZIM Loan is repayable at the option of BNZIM at any time on or after five years from the anniversary of the BNZIM Loan, or following the occurrence of a Regulatory Event, a Loan Repayment Event, the Call (see paragraph 45), or a Tax Event (clause 6.1 of the BNZIM Loan Agreement).
37. BNZIM must repay the BNZIM Loan in whole following the redemption, buy back, or acquisition of BNZ Preference Shares. In this regard, clause 6.2 of the BNZIM Loan Agreement states:

The Borrower shall repay the Loan (in whole but not in part) together with any unpaid interest (accrued since the last Interest Payment Date) calculated at the applicable Interest Rate on the number of days elapsed since the last Interest Payment Date and on the basis of

a 365 day year, immediately following the redemption, buy back or acquisition of the BNZ PPS.

38. Following the occurrence of a Transfer Event (as described in paragraph 39), BNZIM will repay the BNZIM Loan by transferring the BNZ Preference Shares to BNZIS. Such transfer will be deemed to be in full satisfaction of BNZIM's obligations under the BNZIM Loan Agreement.

39. Transfer Events are defined in clause 1.1 of the BNZIM Loan Agreement:

Transfer Event means the occurrence of an APRA Event, a Liquidation Event, a Distribution Non-Payment Event or a BNZ Distribution Event.

Broadly, the Transfer Events comprise:

- NAB failing to meet certain APRA requirements or being subject to the Australian equivalent of statutory management;
- non-payment of interest where the conditions to payment of interest under the BNZIM Loan have been satisfied;
- BNZIS, BNZIM, or BNZ going into liquidation or statutory management; and
- BNZ paying an ordinary dividend when it has not paid dividends on the BNZ Preference Shares.

40. BNZIS's rights under the BNZIM Loan are limited in recourse to the BNZ Preference Shares, distributions on those BNZ Preference Shares or the proceeds of their sale (clause 10 of the BNZIM Loan and the definition of "Collateral" in clause 3.1 of the Security Trust Deed). BNZIS does not have recourse to any other assets of BNZIM.

41. BNZIM's obligation to transfer the BNZ Preference Shares to BNZIS is secured by a security interest over the BNZ Preference Shares in favour of the trustee under the Security Trust Deed.

BNZ Preference Shares

42. BNZIM invested the funds raised from the BNZIM Loan in subscription for the BNZ Preference Shares. These shares:

- on a liquidation of BNZ, rank in priority to ordinary shares issued by BNZ and have a right to receive an amount equal to their issue price plus the dividend accrued from the last dividend payment date (clause 25.9 of the BNZ Constitution);
- are non-voting shares, except as to certain matters such as matters affecting their rights, privileges, or limitations (clause 25.10 of the BNZ Constitution);
- pay a dividend on generally the same basis as the BNZIS Shares pay a dividend (but including the condition that directors of BNZ must be satisfied that payment of the dividend will not cause BNZ's capital ratios to cease complying with Reserve Bank of New Zealand's then current capital adequacy requirements) (clause 25.5 of the BNZ Constitution); and
- have a right to such dividend in priority to the payment of dividends on the ordinary shares issued by BNZ (clause 25.2 of the BNZ Constitution).

43. If a dividend is not paid on the BNZ Preference Shares on a dividend payment date, BNZ is not permitted to declare or make any distributions or payments on, or with respect to, any other shares in the capital of BNZ that rank equally with or junior to the BNZ Preference Shares (other than pro rata payments or distributions on shares that rank equally with the BNZ Preference Shares) unless and until:
- BNZ has paid dividends in full on the BNZ Preference Shares on two consecutive dividend payment dates immediately following that dividend payment date; or
 - the call over the BNZIS Shares is exercised and the BNZIS Shares have been transferred in accordance with the terms of the call.
44. BNZ used the funds obtained by way of the issue of the BNZ Preference Shares for general business purposes, which may have included using them to repatriate funds back to the NAB Group in Australia. Any such repatriation may be by way of a dividend, a share or loan repayment, or another mechanism.

Termination: Call over BNZIS Shares

45. Under the terms of the BNZIS Shares, NAB is granted a call option (“the Call”) over the BNZIS Shares, which it can exercise subject to its obtaining APRA’s prior written approval. Clause 6.9 of the BNZIS Constitution states that NAB has this right in the following circumstances:
- (a) on the Initial Call Date (or on any Dividend Payment Date falling after that date, as specified in the Call Notice);
 - (b) at any time following a redemption, buy back or acquisition of the BNZ PPS; or
 - (c) at any time after the occurrence of a Regulatory Event, a Loan Repayment Event or a Tax Event.
46. The Call may be exercised before the fifth anniversary on the happening of certain events that, broadly speaking, diminish the benefits to the NAB Group of the BNZIS Shares being on issue. These are referred to as Regulatory Events and Tax Events. The Call may also be exercised if certain other structurally significant events affecting BNZIS or BNZIM occur, referred to as Loan Repayment Events, or the BNZ Preference Shares are redeemed, bought back or acquired.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

- a) During the period of the Ruling, the BNZIS Shares will be listed on the NZDX or another “recognised exchange” as defined in section YA 1.
- b) During the period of the Ruling, BNZIS is not treated under a double tax agreement as not being resident in New Zealand.
- c) During the period of the Ruling, ordinary shares in BNZIS will only be held by a person who also holds BNZIS Shares.
- d) During the period of the Ruling, each holder of a BNZIS Share has rights in relation to all the proceeds from the BNZIM Loan.

- e) During the period of the Ruling, BNZIS will be an "ICA company" as defined in section YA 1.
- f) During the period of the Ruling, any distributions made by BNZIS in respect of the BNZIS Shares will be fully credited for the purposes of section CD 43(26) of the Act to the extent permitted by the imputation credits that the directors of BNZIS determine are available.
- g) During the period of the Ruling, income derived by BNZIS will to the extent of 90 percent or more be derived from interest it receives on its loan to BNZIM.
- h) During the period of the Ruling, BNZIS will not cancel the election it has made to be a PIE under section HL 11.
- i) During the period of the Ruling, the Constitution of BNZIS will not be materially altered or amended from the version provided to Inland Revenue on 11 April 2008 (as part of the application for a binding ruling) in a manner that relates to the eligibility requirements to be a PIE and a PLC set out in the Act.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any condition stated above, the Taxation Laws apply to the Arrangement as follows:

- A distribution in respect of the BNZIS Shares is "excluded income" under section CX 56(3) of a holder of the BNZIS Shares who is:
 - (i) A New Zealand resident who is a natural person or a trustee and who does not elect to include the amount of such distributions in that holder's return of income for the applicable year; and
 - (ii) A person not referred to in paragraph (i) above to the extent to which the amount of the distribution is not fully imputed as described in section RF 9(2).
- Section GB 35 does not apply to the Arrangement.
- Section BG 1 does not apply to vary or negate the above conclusions

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 28 March 2008 and ending on 28 March 2013.

This Ruling is signed by me on the 5th day of February 2009.

Howard Davis
Director (Taxpayer Rulings)