SPEAKMAN LAW

Convertible Notes or Preference Shares

The choice of raising funds by way of an issue of convertible notes or preference shares is usually driven by a mixture of security and tax considerations. Convertible notes offer the lender the ability to take security. Preference shares do not confer that advantage (although it is often possible to attach rights to the shares and to structure the issuing company as a lock box company so as to achieve the same economic position as a security holder).

Tax wise the results of convertible notes and preference shares are in many respects the same but in some ways are different. They are the same (with care taken in drafting) when considering the measurement of ownership rules, which are relevant to the carry forward of losses and imputation credits. They are also the same, broadly, insofar as return of capital is concerned (although many factors are relevant here which can come into play to cause a different result, such as arrangements to return capital in lieu of dividend).

The tax results as between convertible notes and preference shares differ when it comes to coupon returns. Returns on preference shares take the character of a dividend. Consequently imputation credits may be attached to those returns. That is not the case with convertible notes. Such instruments (prior to conversion) are debt instruments and the coupon takes the character of interest (except insofar as they are attributable to the underlying shares). These interest payments will generally be deductible to the payer/assessable to the recipient and in some instances will attract resident withholding tax (or non-resident withholding tax where the holder is a non-resident).

Implementing a convertible note or a preference share issue is usually not terribly difficult. We would be happy to provide further advice in these respects or to assist in their implementation.