



# ***CR 2004/64 - Income tax: exchange of shares in Grainco Australia Limited for shares or cash in GrainCorp Limited***

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## Class Ruling

### Income tax: exchange of shares in Grainco Australia Limited for shares or cash in GrainCorp Limited

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#### ***Preamble***

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

#### **What this Class Ruling is about**

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

#### **Tax law(s)**

2. This Ruling relates to the application of the following provisions of the *Income Tax Assessment Act 1997* (ITAA 1997):

- section 6-5;
- section 6-10;
- section 104-25;
- section 104-155;
- section 116-20;
- Subdivision 124-M; and
- Division 725.

This Ruling also deals with the following provisions of the *Income Tax Assessment Act 1936* (ITAA 1936):

- subsection 44(1);
- section 45A;
- section 45B; and
- Part IVA.

## **Class of persons**

3. The class of persons to which this Ruling applies is the B Class shareholders and A Class shareholders (including the holders of former B Class shares which have been converted into A Class shares) in Grainco Australia Limited (GAL) who:

- are 'residents of Australia' as defined in subsection 6(1) of the ITAA 1936;
- participate in the scheme of arrangement for the merger of GAL and GrainCorp Limited (GrainCorp); and
- (with respect to the availability of scrip for scrip roll-over) are not 'significant stakeholders' or 'common stakeholders' within the meaning of those expressions as used in Subdivision 124-M.

4. For the purposes of this Ruling, these persons, as defined above, are referred to as 'participants'.

## **Qualifications**

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 12 in this Ruling.

7. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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## Date of effect

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9. This Ruling applies to the 2003-04 income year.

## Arrangement

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10. The arrangement that is the subject of this Ruling is described below. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- (a) application for a class ruling, dated 12 February 2004, with respect to the shareholders in Grainco Australia Limited (GAL) and arising from the merger transaction between GAL and GrainCorp Limited (GrainCorp);
- (b) copy of the Constitution of GAL;
- (c) copy of Notice of Meeting of B Class Shareholders and Explanatory Memorandum 29 May 2003 (GAL);
- (d) copy of Notice of Meeting Booklet (GAL) 15 August 2003 containing Notice of Meeting of A Class Shareholders, Notice of Meeting of A & B Class Shareholders, Notice of General Meeting and Explanatory Memorandum about the Shareholder Resolutions;
- (e) copy of Information Memorandum (GAL); and
- (f) copy of Merger Implementation Agreement (GAL and GrainCorp) dated 16 June 2003.

11. These documents, or relevant parts of them, as the case may be, form part of and are to be read in conjunction with this description.

12. Under the arrangement that is the subject of this Ruling, GrainCorp acquired 100% of GAL in accordance with a Merger Implementation Agreement. This agreement was implemented on 1 October 2003 by GAL and GrainCorp, and consisted of the following steps:

- amendment of GAL's Constitution to permit B Class shares to be converted to A Class shares;
- conversion of all B Class GAL shares to A Class GAL shares;
- variation of the rights of A Class shares;
- cancellation by GAL of all A Class shares held by participants at 1 October 2003;
- issue by GAL on 1 October 2003 of one A Class share to GrainCorp; and

- payment to participants of cash by GrainCorp, and/or issue to participants of reset preference shares in GrainCorp.

## Ruling

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13. The rulings as outlined below are subject to the qualifications in paragraphs 5 to 8 of this Ruling.

### **Variation of rights of GAL A Class shares and conversion of GAL B Class shares to A Class shares**

14. The variation in the rights originally attached to A Class shares and the conversion of B Class shares to A Class shares does not result in the happening of CGT event C2 or CGT event H2 (sections 104-25 and 104-155 of the ITAA 1997).

15. The variation in the rights originally attached to A Class shares and the conversion of B Class shares to A Class shares does not result in CGT event K8 in section 104-250 of the ITAA 1997 happening. Nor do the variation and conversion result in a requirement to modify the cost base and reduced cost base of those shares under the direct value shifting provisions contained in Division 725 of the ITAA 1997.

16. The variation in the rights originally attached to A Class shares and the conversion of B Class shares to A Class shares does not result in assessable income being derived by the participants under section 6-5 or section 6-10 of the ITAA 1997.

### **Cancellation of GAL A Class Shares**

17. The cancellation of the A Class shares by GAL, together with the payment by GrainCorp, does not result in any assessable income being derived by the participants (other than a capital gain) under section 6-5 or section 6-10 of the ITAA 1997 or subsection 44(1), section 45A or section 45B of the ITAA 1936.

18. However, the cancellation of each A Class share (including the newly converted shares) will result in CGT event C2 in section 104-25 of the ITAA 1997 happening. The participants will make a capital gain from this event if the capital proceeds for each share are more than its cost base. They will make a capital loss if the capital proceeds are less than the share's reduced cost base.

19. It is considered that the capital proceeds from the cancellation of the GAL shares will be the total, as worked out at the time of the event, of the money and/or the market value of any property that the participants received or were entitled to receive under the arrangement (section 116-20 of the ITAA 1997).

**Scrip for scrip rollover relief**

20. The participants can choose roll-over, under Subdivision 124M of the ITAA 1997, to the extent that they exchange a GAL share acquired on or after 20 September 1985 for a GrainCorp share if:

- (a) apart from the roll-over they would make a capital gain in relation to the cancellation of their GAL share; and
- (b) might make a capital gain from a replacement reset preference share in GrainCorp which would not be disregarded (except because of a roll-over).

21. Participants will not be entitled to choose scrip for scrip roll-over in relation to shares for which they have received only cash as consideration for the cancellation of their GAL shares.

**Application of Part IVA of the ITAA 1936**

22. Having regard to the facts of the arrangement, Part IVA of the ITAA 1936 does not apply.

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**Explanation**

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**Taxation consequences of the variation of share rights*****CGT event C2***

23. Taxation Ruling TR 94/30 (paragraph 8) provides that a variation of the rights attaching to a share does not result in a disposal of an asset for CGT purposes unless there was a cancellation or redemption of the share.

24. In the context of the rewritten CGT provisions Taxation Ruling TR 94/30 is still in effect. Therefore, the variation of the rights attached to GAL A Class Shares and the conversion of GAL B Class Shares to A Class Shares does not result in CGT event C2 (about cancellation, surrenders and similar endings) happening.

***CGT event H2***

25. CGT event H2 (section 104-155 of the ITAA 1997) happens if:

- an act, transaction or event occurs in relation to a CGT asset;
- the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base; and
- the capital proceeds from the event are more than the incidental costs incurred in relation to it.

26. Subsection 116-20(2) of the ITAA 1997 provides that the capital proceeds from CGT event H2 are the money or other consideration received because of the act, transaction or event.

27. In this case an act or event has occurred in relation to the various shares, namely the variation made to the former GAL B Class shares which were converted to GAL A Class shares.

28. CGT event H2 does not happen as the variation of the rights attaching to the shares does not result in a disposal or deemed disposal of a capital gains asset and no capital proceeds were received or entitled to be received by the shareholders in connection with the variation of rights.

### ***CGT event K8 and share value shifting provisions***

29. Variation of share rights for one class of shares but not another is an example of where direct value shifts may apply. However, a direct value shift will not have consequences under Division 725 of the ITAA 1997 if the sum of the decreases in market value of all the down interests under the same scheme does not exceed \$150,000 (subsection 725-70(1)). Under the arrangement, the total decrease in the market value of the existing GAL A Class shares is less than the threshold of \$150,000 in subsection 725-70(1).

30. As the total decrease in market value of the existing GAL A Class shares attributable to any direct value shift is less than \$150,000, subsection 725-70(1) of the ITAA 1997 will preclude the arrangement from any consequences under the direct value shifting rules in Division 725.

31. Accordingly, CGT event K8 (section 104-250 of the ITAA 1997) does not happen and no adjustment is required to be made to the cost base of any of the shares.

### ***Sections 6-5 and 6-10 of the ITAA 1997***

32. Assessable income consists of income according to ordinary concepts and some amounts that are not ordinary income but are included in assessable income by other provisions (sections 6-5 and 6-10 of the ITAA 1997).

33. No amount of money or property is derived by the taxpayer as a result of the variation in the rights of the participants' shares. Therefore, no amount is included in assessable income under section 6-5 or section 6-10 of the ITAA 1997 as a result of the variation in the rights of the GAL shares.

**Taxation consequences of the share cancellation*****Sections 6-5 and 6-10 of the ITAA 1997***

34. In form and substance, the payment to the participants constitutes the consideration paid in return for the cancellation of these shares. Thus, unless the shares were held on revenue account, the payment is capital in nature and therefore does not constitute income according to ordinary concepts under section 6-5 of the ITAA 1997.

35. Furthermore, the payment from GrainCorp does not constitute statutory income, other than to the extent that it is relevant in determining the amount of a net capital gain, for the purposes of section 6-10 of the ITAA 1997.

***Subsection 44(1) of the ITAA 1936***

36. Under the arrangement, as described, there is no distribution by GAL, whether in money or property, nor will GAL be crediting an amount to the participants as shareholders in GAL as is required under the definition of 'dividend' in subsection 6(1) of the ITAA 1936.

37. The payment from GrainCorp is the only amount received by the participants which was made in return for the cancellation of the participants' shares as part of a wider arrangement and therefore cannot be considered a dividend under subsection 6(1) of ITAA 1936.

38. Accordingly, the arrangement does not give rise to an amount being included in a participant's assessable income under subsection 44(1) of the ITAA 1936.

***Section 45A of the ITAA 1936***

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

40. There is no provision of a capital benefit, as defined by subsection 45A(3) of the ITAA 1936, nor are there any disadvantaged shareholders by whom it is reasonable to assume that dividends will be received. Thus, section 45A does not apply to give rise to an amount being included in a participant's assessable income.

***Section 45B of the ITAA 1936***

41. Section 45B of the ITAA 1936 is also an anti-avoidance provision which applies if certain capital benefits are provided to shareholders in substitution for dividends. Specifically, the provision applies where:



- (a) there is a scheme under which a person is 'provided with a capital benefit' by a company;
- (b) under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, 'obtains a tax benefit'; and
- (c) 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.

42. The arrangement for the exchange of GAL shares for cash or GrainCorp shares is a 'scheme' within the broad meaning of that term. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) to mean:

- (a) the provision of ownership interests in a company to the relevant person;
- (b) the distribution to the relevant person of share capital or share premium; and
- (c) something that is done in relation to an ownership interest that has the effect of increasing the value of an ownership interest that is held by the person.

43. Under the arrangement, participants who receive GrainCorp reset preference shares will be provided with a capital benefit within the meaning of paragraph 45B(5)(a) of the ITAA 1936. These participants will also 'obtain a tax benefit', within the meaning conveyed by subsection 45B(9). However, having regard to the relevant circumstances as set out in subsection 45B(8), it cannot reasonably be concluded that the arrangement was entered into, or carried out, with the requisite degree of purpose of enabling a person to obtain a tax benefit.

44. Section 45B of the ITAA 1936 therefore does not apply to give rise to an amount being included in a participant's assessable income.

## **CGT event C2**

45. Paragraph 104-25(1)(a) of the ITAA 1997 provides that CGT event C2 happens if a taxpayer's ownership of an intangible CGT asset ends because it is redeemed or cancelled. The cancellation of shares will trigger CGT event C2.

46. Effectively the arrangement resulted in the cancellation of the GAL A Class shares (including the newly converted shares) which resulted in CGT event C2 happening to each share.

47. A capital gain or loss from CGT event C2 is determined by calculating the difference between the capital proceeds received or to

be received from the CGT event and the cost base/reduced cost base of the CGT asset (subsection 104-25(3) of the ITAA 1997).

### **Capital proceeds from cancellation of shares**

48. The cancellation of the GAL A Class shares (including the newly converted shares) gave rise to CGT event C2. The capital proceeds will be determined under Division 116 of the ITAA 1997.

49. Subsection 116-20(1) of the ITAA 1997 provides that capital proceeds includes the total of the money and the market value of any property received, or entitled to be received, in respect of the event happening.

50. Both the receipt of money and the issue of shares can fall within subsection 116-20(1) of the ITAA 1997. The receipt of money is provided for in paragraph 116-20(1)(a) and the issue of shares is provided for in paragraph 116-20(1)(b) as the market value of property received in respect of a CGT event happening.

51. The fact that a third party made the payment and/or issued the shares does not prevent the money or the market value of the shares from constituting capital proceeds.

52. In this case the Merger Implementation Agreement establishes a nexus between the payment of the money and/or issue of GrainCorp reset preference shares and the cancellation of the GAL shares. Therefore, it is considered that the money received and/or GrainCorp reset preference shares issued to the participants as consideration for the cancellation of the participants' GAL shares are capital proceeds for the purposes of section 116-20 of the ITAA 1997 in respect of CGT event C2.

### **Eligibility for scrip for scrip roll-over**

53. Subdivision 124-M of the ITAA 1997 provides an entitlement to choose scrip for scrip roll-over to the extent that shares are exchanged for shares in the acquiring company.

54. Roll-over will be available for a GAL shareholder if certain conditions are satisfied. Below is an outline of the main conditions and exceptions that are relevant to the circumstances of the arrangement that is the subject of this Ruling.

*Subparagraph 124-780(1)(a)(i) of the ITAA 1997 requires an entity to exchange a share in a company (the 'original entity') for a share in another company*

55. This requirement is satisfied by the participants to the extent that they received GrainCorp reset preference shares as consideration for cancellation of their GAL A Class shares.

56. It is not a requirement of subparagraph 124-780(1)(a)(i) of the ITAA 1997 that the rights attaching to the replacement shares received by the participants should be the same as rights attaching to the GAL shares.

57. The Explanatory Memorandum to the New Business Tax System Capital Gains Tax Bill 1999 indicates that rollover is available if 'a share in a company is exchanged for a share in another company ...even if the rights attaching to the share ... are different'.

*Paragraphs 124-780(1)(b) and 124-780(2)(a) of the ITAA 1997 require that the exchange of shares is in consequence of a single arrangement that results in the acquiring entity (GrainCorp) becoming the owner of 80% or more of the voting shares in the original entity (GAL)*

58. In the context of the scrip for scrip roll-over provisions, the merger of GrainCorp and GAL pursuant to the Merger Implementation Agreement is considered to be a 'single arrangement'.

59. The only shares that satisfy the definition of 'voting shares' in subsection 995-1(1) of the ITAA 1997 are the GAL A Class shares.

60. Accordingly, following implementation of the merger on 1 October 2003 this requirement was satisfied since GrainCorp became the owner of the only voting share in GAL.

*Paragraphs 124-780(1)(b) and 124-780(2)(b) of the ITAA 1997 require that the exchange of shares is in consequence of a single arrangement in which at least all owners of voting shares in the original entity (GAL) could participate*

61. This condition is satisfied because all the owners of GAL A Class shares (including the owners of the former GAL B Class shares which were converted to GAL A Class shares) disposed of their shares in exchange for GrainCorp shares as a result of the arrangement.

*Paragraphs 124-780(1)(b) and 124-780(2)(c) of the ITAA 1997 require that the exchange of shares is in consequence of a single arrangement in which participation was available on substantially the same terms for all of the owners of interests of a particular type in the original entity (GAL)*

62. This requirement is satisfied as the same offer was made to each GAL A Class shareholder (including each former GAL B Class shareholder).

*Paragraphs 124-780(1)(c) and 124-780(3)(a) of the ITAA 1997 require the original interest holder (GAL shareholder) to have acquired its original interest (its GAL shares) on or after 20 September 1985*

63. This condition will be satisfied by a GAL A Class shareholder in relation to the shares they acquired on or after 20 September 1985. Paragraph 20 limits this Ruling to shares acquired on or after this date.

*Paragraphs 124-780(1)(c) and 124-780(3)(b) of the ITAA 1997 require that, apart from the roll-over, the original interest holder (GAL shareholder) would make a capital gain from a CGT event happening in relation to its original interest (its GAL shares)*

64. Whether a GAL shareholder would, apart from the roll-over, make a capital gain from the disposal of any of its shares to GrainCorp is a question of fact that is dependent on the specific circumstances of each shareholder - in particular the cost base of each GAL share and the value of the capital proceeds received. The Ruling is qualified at paragraph 20(a) in this regard.

*Paragraphs 124-780(1)(c) and 124-780(3)(c) of the ITAA 1997 require that the replacement interest is in the acquiring entity (GrainCorp), or the ultimate holding company of the wholly owned group which includes the acquiring entity (GrainCorp)*

65. This requirement is satisfied as the Merger offer was made by GrainCorp and, to the extent that the offer consideration provided reset preference shares, the shares were in GrainCorp.

*Subsection 124-780(4) of the ITAA 1997 provides for additional requirements if the original interest holder (GAL shareholder) and an acquiring entity (GrainCorp) did not deal with each other at arm's length and:*

- (a) neither the original entity (GAL) nor the replacement entity (GrainCorp) had at least 300 members just before the arrangement started; or*
- (b) the GAL shareholder, the original entity (GAL) and an acquiring entity (GrainCorp) were all members of the same linked group just before the arrangement started*

66. Paragraph 124-780(4)(a) of the ITAA 1997 does not apply as both GAL and GrainCorp had more than 300 members just before the arrangement started (section 124-810 of the ITAA 1997 does not apply to GAL as its ownership is not concentrated in the manner contemplated by that section).

67. Paragraph 124-780(4)(b) of the ITAA 1997 will not apply because both GAL and GrainCorp were not members of the same linked group (within the meaning in section 170-260 of the ITAA 1997) just before the merger started.

*Subsection 124-790(1) of the ITAA 1997 provides that only a partial roll-over is available if the capital proceeds for the original interest (GAL A Class shares) include something other than the replacement interest (reset preference shares in GrainCorp)*

68. To the extent that a GAL shareholder received cash from GrainCorp for a GAL A Class share, scrip for scrip roll-over is not available. The cost base of the part of the GAL A Class share for which roll-over is not available is so much of the cost base of the share as is reasonably attributable to the cash received.

*Subsection 124-795(1) of the ITAA 1997 provides that the roll-over is not available if just before you (the GAL shareholder) stop owning your original interest (the GAL shares), you are not an Australian resident unless, just after you acquire your replacement interest (shares), the replacement entity (GrainCorp) is an Australian resident for CGT purposes*

69. The class of persons to which this class ruling is applicable is limited to residents of Australia as defined in subsection 6(1) of the ITAA 1936. Therefore, this condition is not relevant.

*Paragraph 124-795(2)(a) of the ITAA 1997 provides that the roll-over is not available if any capital gain you (the GAL shareholder) might make from your replacement interest (the shares) would be disregarded*

70. This Ruling is limited to those participants who might make a capital gain from a replacement interest in GrainCorp which would not be disregarded (except because of a roll-over) – refer to paragraph 20(b).

*Paragraph 124-795(2)(b) of the ITAA 1997 provides that the roll-over is not available if you (the GAL shareholder) and the acquiring entity (GrainCorp) are members of the same wholly owned group just before you stop owning your original interest (the GAL shares)*

71. This Ruling is made on the basis that neither GrainCorp nor any GrainCorp group company held any shares in GAL before the arrangement.

**Application of the general anti-avoidance provisions**

72. For Part IVA of the ITAA 1936 to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (sections 177A(5) and 177D of the ITAA 1936). In this case, the arrangement for the merger of GAL and GrainCorp, including the changes to the constitution of GAL is the 'scheme'.

73. However, even if it can be said that a 'tax benefit' was obtained by the participants having regard to the matters contained in paragraph 177D(b) of the ITAA 1936 it cannot be concluded that the scheme was entered into or carried out for the dominant purpose of enabling a participant to obtain a tax benefit.

**Detailed contents list**

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**Commissioner of Taxation**

23 June 2004

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Not previously issued as a draft	- shares acquired
	- variation in share rights
<i>Related Rulings/Determinations:</i>	<i>Legislative references:</i>
CR 2001/1; TR 92/1; TR 94/30;	- Copyright Act 1968
TR 97/16	- TAA 1953 Pt IVAAA
<i>Subject references:</i>	- ITAA 1936 6(1)
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