


# ***CR 2011/74 - Income tax: conversion of shares and variations in rights - Bega Cheese Limited***

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## Class Ruling

### Income tax: conversion of shares and variations in rights – Bega Cheese Limited

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#### **ⓘ This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

### Relevant provisions

2. The relevant provisions dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Section 6-10 of the ITAA 1997;
- Division 104 of the ITAA 1997;
- Section 112-25 of the ITAA 1997;
- Division 725 of the ITAA 1997; and
- Division 727 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

## Class of entities

3. The class of entities to which this Ruling applies are the holders of A Class shares and the holders of B Class shares in Bega Cheese Limited (Bega Cheese) who:

- have their Bega Cheese shares converted into ordinary shares under the arrangement described in paragraphs 12 and 13 of this Ruling;
- hold those shares on capital account;
- are the beneficial owners of those shares;
- are residents of Australia for tax purposes as defined in subsection 6(1) of the *Income Tax Assessment Act 1936* who are entitled to participate in the Scheme; and
- are not subject to the taxation of financial arrangement rules in Division 230 in relation to gains and losses on their shares.

(Note: Division 230 will not generally apply to individuals, unless they have made an election for it to apply to them.)

## Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 15 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme 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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8. This Ruling applies from 21 April 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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## Scheme

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9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- Class Ruling Application dated 23 December 2010;
- current Constitution of Bega Cheese;
- draft new Constitution of Bega Cheese;
- response to request for further information, including copy of Bega Cheese Share Register, dated 28 February 2011; and
- further correspondence dated 2 March 2011, 6 April 2011 and 7 July 2011.

**Note:** certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

### Share capital of Bega Cheese

10. Bega Cheese is a registered company under the *Corporations Act 2001* (Corporations Act). Bega Cheese is a company limited by shares with two classes of shares on issue – A Class shares and B Class shares.

11. Under the current Constitution, the holders of A Class and B Class shares have the right to participate equally in dividends declared by Bega Cheese, and in any other distributions that might be made. However, only A Class shareholders have the right to vote at general meetings.

## **Conversion of shares and modifications to the Bega Cheese Constitution**

12. Under an arrangement (the Scheme), Bega Cheese has taken steps to convert the A Class shares and B Class shares into a larger number of shares, vary the rights attaching to the B Class shares and amend the Constitution.

13. The steps taken in the Scheme were:

- (a) A General Meeting of shareholders was held on 21 April 2011 at which:
  - an ordinary resolution was passed by the A Class shareholders in accordance with section 254H of the Corporations Act to split each of the existing A Class and B Class shares into four shares; and
  - a special resolution was passed by the A Class shareholders in accordance with rule 5.5 of the current Constitution and section 246B of the Corporations Act to:
    - replace the Constitution;
    - convert the A Class shares to ordinary shares; and
    - convert the B Class shares to ordinary shares.
- (b) A second special resolution was passed by B Class shareholders to approve the conversion of the B Class shares to ordinary shares.
- (c) The first General Meeting special resolution was subject to the passing of the B Class shareholder special resolution.
- (d) The conversion of the A Class shares and the B Class shares into ordinary shares and the adoption of a new constitution was effected on 18 July 2011, being the date Bega Cheese lodged with the Australian Securities Investment Commission a prospectus in connection with the initial public offering of ordinary shares and its listing on the Australian Stock Exchange.

## **Shareholding of Bega Cheese**

14. The largest shareholder in Bega Cheese owns 4.62% of the shares.

15. The variation of rights attaching to the shares does not result in an increased market value of the ordinary shares that relate to the B Class shares or a decrease in market value of the ordinary shares that relate to the A Class shares.

## **Ruling**

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### **Capital gains tax**

16. The splitting of the A Class and B Class shares into a greater number of ordinary A Class and ordinary B Class shares will not result in a CGT event in Division 104 happening (subsections 112-25(1) and (2)).

17. The new ordinary shares will have:

- the same acquisition date as the original A Class and B Class shares to which they relate; and
- a cost base and reduced cost base that is based on a reasonable apportionment of the cost base and reduced cost base of the original A Class and B Class shares to which they relate (subsection 112-25(3)).

18. The variation of the rights attached to the B Class shares, which are converted to ordinary shares, will cause CGT event H2 in section 104-155 to happen in respect of those shares. However, no shareholder will make a capital gain as a result of the event happening as they will not receive capital proceeds.

19. No other CGT event in Division 104 will happen as a result of the conversion of A Class and B Class shares to ordinary shares.

### **Value shifting provisions**

20. The arrangement involving the variation of share rights is not one to which any of the consequences in Divisions 725 and 727 will apply.

### **Assessable income**

21. The splitting of the A Class and B Class shares, the conversion of shares and the variation of share rights will not result in any assessable income being derived by any shareholder to whom this Ruling applies under sections 6-5 (about ordinary income) or under section 6-10 (about statutory income) as a result of a CGT event.

## Appendix 1 – Explanation

**❶** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### **CGT: splitting of shares**

22. If a CGT asset is split into two or more assets and the beneficial owner of the original asset and of each new asset is the same, the splitting is not a CGT event (subsections 112-25(1) and 112-25(2)).

23. Under the Scheme, there will be no cancellation or redemption of the A Class or B Class shares. Each of the original A Class and B Class shares will split into four new shares. The beneficial owner of each original share will be the beneficial owner of the four new shares resulting from the share split. Accordingly, this splitting of the shares is not a CGT event.

24. As no CGT event happens, there is no change in the acquisition date of the shares. That is, the acquisition date of the new shares is the same as the acquisition date of the original share to which they relate. For example, if an original A Class share was acquired before 20 September 1985, the four new shares to which that original share relates will also be taken to have been acquired before that date.

25. The cost base and reduced cost base of each new share is worked out by apportioning in a reasonable way each element of the cost base and reduced cost base of the original share to each new share (subsection 112-25(3)).

26. In this case, the Commissioner is satisfied that a reasonable apportionment will be obtained by dividing the cost base and reduced cost base of each original share by four.

### **CGT: conversion of A Class and B Class shares into ordinary shares**

27. The conversion of the A Class and B Class shares into ordinary shares results in a variation of rights.

### **CGT event C2**

28. Shares are comprised of a bundle of rights, however, those rights are not separate pieces of property capable of being divided out and held separately. Accordingly, for CGT purposes, the rights attaching to shares do not constitute individual assets as defined in section 108-5, but rather combine to make up the ultimate asset, being the share (refer to Taxation Ruling TR 94/30).

29. Pursuant to section 104-25, CGT event C2 happens if the ownership of an intangible asset, such as a share, ends by that share being redeemed or cancelled (paragraph 104-25(1)(a)). As the conversion of the A Class and B Class shares into ordinary shares constitutes a mere variation of rights attaching to the shares and does not constitute a redemption or cancellation of the share for CGT purposes, CGT event C2 under paragraph 104-25(1)(a) does not happen.

### **CGT event H2**

30. CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset that you own and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base (subsection 104-155(1)). The variation in the rights attached to the B Class shares is an act, transaction or event in relation to those shares. Therefore, the variation results in CGT event H2 happening in respect of them.

31. A capital gain is made if the capital proceeds from the event are more than the incidental costs incurred in relation to it. A capital loss is made if the capital proceeds are less than the incidental costs (subsection 104-155(3)).

32. Subsection 116-20(2) provides that the capital proceeds from CGT event H2 happening are the money or other consideration received, or entitled to be received, because of the act, transaction or event. Paragraph 29 of Taxation Ruling TR 95/3 provides that 'consideration' for these purposes can include the benefit of mutual promises flowing to parties even if those promises are not in themselves properties.

33. The holders of the B Class shares will not receive or be entitled to receive money or other consideration, nor will they receive the benefit of any mutual promises in respect of the event happening. Further, the splitting of the B Class shares into a larger number of shares does not result in the receipt of consideration because it involves a mere change in the nature of property that is already beneficially owned.

34. Therefore, although CGT event H2 will happen in respect of the B Class shares, the holders of those shares will not make a capital gain. They will make a capital loss to the extent of any incidental costs they incur in respect of the variation.

### **Value shifting consequences**

35. There can be income tax consequences where there is a direct value shift, as defined in section 725-145, or an indirect value shift, as defined in section 727-150. However, there are only consequences where threshold control tests are satisfied.



36. The direct value shifting rules in Division 725 do not apply unless there is an entity that controls (for value shifting purposes) the target entity at some time during a scheme period (paragraph 725-50(b) and section 725-55).

37. The indirect value shifting rules in Division 727 do not apply unless the entities between which value is shifted (the losing and the gaining entity) satisfy an ultimate controller test or a common ownership nexus test (paragraph 727-100(c) and sections 727-105 and 727-110).

38. There are no consequences for any direct value shift or indirect value shift that happens under the arrangement involving the variation in share rights attached to the B Class shares that are converted to ordinary shares. There would be no consequences for any direct value shift as there is no entity that controls (for value shifting purposes) Bega Cheese at any time from when the Scheme is entered into until when it is carried out (paragraph 725-50(b) and section 725-55). There would be no consequences for any indirect value shift as no entity would, together with Bega Cheese, meet the ultimate controller test or common ownership nexus test (paragraphs 727-100(c) and 727-110(1)(a) and section 727-355).

## **Income: conversion and variation**

39. The conversion of shares and the variation of rights will not result in any assessable income being derived by any shareholder to whom this Ruling applies under section 6-5 (about ordinary income) or under section 6-10 (about statutory income) as a result of a CGT event.

## **Appendix 2 – Detailed contents list**

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40. The following is a detailed contents list for this Ruling:

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 94/30; TR 93/5

TR 2006/10

*Subject references:*

- capital gains tax
- CGT capital proceeds
- CGT event
- cost base
- direct value shifting
- indirect value shifting
- shares

*Legislative references:*

- ITAA 1936 6(1)
- ITAA 1997 6-5
- ITAA 1997 6-10
- ITAA 1997 Div 104
- ITAA 1997 104-25
- ITAA 1997 104-25(1)
- ITAA 1997 104-25(1)(a)
- ITAA 1997 104-155(1)
- ITAA 1997 104-155(3)
- ITAA 1997 108-5
- ITAA 1997 112-25
- ITAA 1997 112-25(1)
- ITAA 1997 112-25(2)
- ITAA 1997 112-25(3)
- ITAA 1997 116-20(2)
- ITAA 1997 Div 230
- ITAA 1997 Div 725
- ITAA 1997 725-50(b)
- ITAA 1997 725-55
- ITAA 1997 725-145
- ITAA 1997 Div 727
- ITAA 1997 727-100(c)
- ITAA 1997 727-105
- ITAA 1997 727-110
- ITAA 1997 727-110(1)(a)
- ITAA 1997 727-150
- ITAA 1997 727-355
- TAA 1953
- Corporations Act 2001
- Corporations Act 2001 246B
- Corporations Act 2001 254H
- Copyright Act 1968

ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT events H1 and H2 - special capital receipts