



# ***TR 1999/4 - Income tax: capital gains: changes in majority underlying interests in assets of public entities for Division 20 of Part IIIA of the Income Tax Assessment Act 1936***

 This cover sheet is provided for information only. It does not form part of *TR 1999/4 - Income tax: capital gains: changes in majority underlying interests in assets of public entities for Division 20 of Part IIIA of the Income Tax Assessment Act 1936*

 This document has changed over time. This is a consolidated version of the ruling which was published on *14 April 1999*



## Taxation Ruling

Income tax: capital gains: changes in majority underlying interests in assets of public entities for Division 20 of Part IIIA of the *Income Tax Assessment Act 1936*

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### *Preamble*

*The number, subject heading, **Class of person/arrangement**, **Date of effect** and **Ruling** parts of this document are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. 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 Ruling is about

1. This Ruling is concerned with the discretionary powers given to the Commissioner of Taxation under subsections 160ZZSC(2) and 160ZZSD(2) of the *Income Tax Assessment Act 1936* ('the 1936 Act'). It is also concerned with the special tracing rules set out in sections 160ZZSJ to 160ZZST. Specifically, the Ruling:

- (a) lists matters that the Commissioner takes into account in exercising the discretion under subsection 160ZZSC(2) or 160ZZSD(2);
- (b) considers how an entity may rely on the special tracing rules in an application under subsection 160ZZSC(2) or 160ZZSD(2); and
- (c) outlines the use of the special tracing rules where subsection 160ZZSC(4) requires an entity to examine the underlying interests in its assets at a date earlier than 20 January 1997.

### Cross reference table of provisions

2. Where this Ruling refers to the income tax law, the references are to the 1936 Act. For all test times after 30 June 1998, Division 149 of the *Income Tax Assessment Act 1997* ('the 1997 Act') applies in place of Division 20 of Part IIIA of the 1936 Act. Column 2 of the

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following table shows which provision in the 1997 Act corresponds with each provision in the 1936 Act referred to in the Ruling.

<b>provision in the 1936 Act</b>	<b>provision in the 1997 Act</b>
Division 20 of Part IIIA	Division 149
Subdivision D of Division 20	Subdivision 960-H and subsections 149-55(5), (6) and (7)
Subdivision E of Division 20	Subdivision 149-D and subsections 166-240(2) to 166-245(2)
Subdivision F of Division 20	Subdivision 149-E
Subdivision G of Division 20	Subdivision 149-F
section 160ZZRR	various interpretative provisions
section 160ZZRS	subsection 149-15(4)
section 160ZZRT	subsection 149-15(5)
section 160ZZRU	subsections 149-60(4) and (5)
section 160ZZS	Subdivision 149-B
section 160ZZSA	sections 149-55 and 149-60
subsection 160ZZSA(2)	subsections 149-55(1) and 149-60(1)
subsection 160ZZSA(3)	subsection 149-60(3)
section 160ZZSB	section 149-65
subsection 160ZZSC(2)	no equivalent provision
subsection 160ZZSC(4)	no equivalent provision
subsection 160ZZSD(2)	subsection 149-70(3)
sections 160ZZSF to 160ZZSI	Subdivision 960-H and subsections 149-55(5), (6) and (7)
sections 160ZZSJ to 160ZZST	Subdivision 149-D and subsections 166-240(2) to 166-245(2); Subdivisions 149-E and 149-F
subsection 160ZZSM(2)	subsections 149-120(1) and 149-120(3)
subsection 160ZZSM(3)	subsections 149-125(1) and 149-125(3)
section 160ZZSQ	section 149-140

**Class of person or arrangement**

3. This Ruling applies to public entities to which section 160ZZSA applies. The Ruling does not apply to an entity for the purpose of determining how section 160ZZS applies to the entity in relation to assets disposed of before 20 January 1997.

4. This Ruling is based on the law in Division 20 and on proposed changes to the law announced by the Treasurer on 12 May 1998. Those proposed changes give public entities certainty in the use of the notional holder rule (in Subdivision E of Division 20) by removing the power that the current legislation (section 160ZZSQ) gives to the Commissioner to override the notional holder rule in certain circumstances.

5. There were also proposed new arrangements in the Treasurer's announcement for public entities that examine the underlying interests in their pre-CGT assets at 30 June 1999 and in later years. This Ruling does not apply to any examination of underlying interests under those new arrangements.

**Key terms**

6. In this Ruling:

**'special tracing rules'** refers to the rules set out in sections 160ZZSJ to 160ZZST; and

**'notional holder'** means the fictional natural person referred to in subsection 160ZZSM(2) or 160ZZSM(3) who may be treated as having the rights to certain dividends and distributions of capital from a public company, or to certain income or distributions of capital from a publicly traded unit trust.

7. The terms in column 1 of the following table, when they are used in this Ruling, have the same meanings as they have in section 160ZZRR of the 1936 Act. In some cases, different terms are used in the 1997 Act. These different terms are in column 2; column 3 shows where to find definitions of these terms.

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<b>term in the 1936 Act</b>	<b>term in the 1997 Act</b>	<b>definition</b>
abnormal trading		Subdivision 960-H and subsections 149-55(5), (6) and (7)
base time	starting day	section 149-60
listed public company	no equivalent term	
majority underlying interests		subsection 149-15(1)
mutual insurance organisation	no equivalent term	
natural person	ultimate owner	subsection 149-15(3)
public company	no equivalent term	
public entity	no equivalent term	
publicly traded unit trust		subsection 149-50(2)
test time	test day	subsection 149-55(2)
underlying interest		subsection 149-15(2)

**Background**

8. Section 160ZZS determines when assets acquired by taxpayers (including public entities) before 20 September 1985 ('pre-CGT assets') lose their pre-CGT status as a result of a change in majority underlying interests held by natural persons. Schedule 4 of the *Taxation Laws Amendment Act (No 1) 1997* inserted a new Division 20 into Part IIIA of the 1936 Act, which removed public entities (public companies, publicly traded unit trusts and mutual insurance organisations) from the application of section 160ZZS from 20 January 1997. It also amended the way certain public entities determine whether pre-CGT assets become subject to the capital gains tax provisions because of a change in the majority underlying interests in those assets.

9. Division 20 requires public entities to determine, at certain prescribed times, whether the majority underlying interests in their pre-CGT assets are held by the same natural persons who held those interests at the base time (the last moment of 19 September 1985 or an alternative time within the period 1 July 1985 to 30 June 1986 that gives a reasonable approximation of underlying interests as at 19 September 1985). If the same natural persons did not hold the majority underlying interests in the assets at the base time and at the

test time, the pre-CGT assets are taken to have been acquired at the test time or at an earlier time at which the public entity should have examined the underlying interests under section 160ZZS. The public entity is required to determine the cost base of the assets for capital gains tax purposes on the basis of their market value at the relevant time.

10. To assist in the determination, Subdivisions E, F and G of Division 20 contain special tracing rules that relieve public companies and publicly traded unit trusts of the need, in some circumstances, to identify the natural persons who hold the underlying beneficial interests in their pre-CGT assets.

11. Subsections 160ZZSC(2) and 160ZZSD(2) in Division 20 give discretionary powers to the Commissioner to help to overcome the difficulties some entities may face in tracing the holders of underlying interests. If a public entity determines under subsection 160ZZSA(2) that the same natural persons did not hold the majority underlying interests in a pre-CGT asset at the base time and at a test time, the effect of subsections 160ZZSC(2) and 160ZZSD(2) is that that determination is disregarded if the Commissioner is satisfied, or considers it reasonable to assume, the same natural persons did hold the majority underlying interests at both times. This could occur, for example, if a public company cannot fully trace through its shares to natural persons but can otherwise demonstrate that it would be reasonable for the Commissioner to assume the same natural persons had continued to hold the majority underlying interests in the company's pre-CGT assets.

12. This Ruling discusses the nature of a determination under Division 20. It also contains guidelines for the exercise of the discretions in subsections 160ZZSC(2) and 160ZZSD(2) but it is essential that each case is dealt with on its merits. Officers exercising the discretions should record in detail the matters they have taken into account in their exercise of them.

13. If the proposed changes affecting the notional holder rule as announced by the Treasurer on 12 May 1998 do not become law, we will change this Ruling to take into account the Commissioner's power in section 160ZZSQ.

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## **Ruling**

### **Public entities to determine changes in majority underlying interests**

14. Section 160ZZSA directs a public entity to which it applies to examine its records (and 'its records' may include information the entity receives or that is available from related entities or other

sources) and determine whether the same natural persons held the majority underlying interests in its pre-CGT assets at the base time and at a test time. In making its determination a public entity cannot rely on assumptions, other than the assumptions specifically provided for in Division 20. A determination that is not based wholly on actual records of underlying interests, after making any assumptions that apply to the entity under Division 20, is not a valid determination. An entity that does not make a valid determination within the time allowed may be taken to have acquired its pre-CGT assets on 20 September 1985 or on another date determined under section 160ZZSB.

**Exercise by the Commissioner of the discretion under subsection 160ZZSC(2) or 160ZZSD(2)**

15. When asking the Commissioner to exercise the discretion under subsection 160ZZSC(2) or 160ZZSD(2), an entity should state in detail the grounds for the application, and include all information that might indicate the same natural persons have or have not continued to hold certain underlying interests and all information that could assist in making assumptions about the extent to which underlying interests have or have not continued to be held by the same natural persons.

16. The Commissioner takes into account the following matters (if they are relevant in the particular case) in deciding whether to exercise the discretion in subsection 160ZZSC(2) or 160ZZSD(2) in favour of a public entity:

- the time that has elapsed between the base time and the test time;
- the extent of trading in, or creation and cancellation of, shares, units or other membership interests of the entity;
- known changes in underlying interests and the extent of the underlying interests that have been shown not to have changed;
- known changes in registered interests in the entity and the extent of the registered interests known not to have changed;
- the nature and identity of registered shareholders, unitholders or members of the public entity;
- the nature and identity of registered shareholders, unitholders or members of an interposed entity;

- the extent of efforts made to identify underlying interests;
- the reasons why further tracing of underlying interests cannot or will not be carried out;
- the likelihood that further attempts to trace, if they were made, would be successful in identifying underlying interests;
- the state of records held, and the reasons for any deficiency in the records;
- the rationale for any exercise of a discretion under the 1936 Act or under the 1997 Act in relation to a public entity, or in relation to an entity related to the public entity, where the beneficial ownership of shares or units in the public entity was considered in exercising the discretion;
- details of any examination of beneficial ownership by the public entity, or by an entity related to the public entity, for the purposes of any provision of the 1936 Act or the 1997 Act;
- the extent of trading in, or creation and cancellation of, shares, units or other membership interests of entities interposed between the public entity and holders of underlying interests in its assets; and
- any other matter relevant to an exercise of the discretion in the circumstances of the particular case.

### **Reliance on the special tracing rules when applying for the discretion to be exercised**

17. In making a case for consideration under subsection 160ZZSC(2) or 160ZZSD(2), a public company or publicly traded unit trust may ask the Commissioner to rely on the special tracing rules and, where relevant, on the concession in paragraphs 19 and 20 of this Ruling. If the Commissioner is satisfied, or considers it reasonable to assume, from the information supplied, the same natural persons held the majority underlying interests in a pre-CGT asset of the company or trust at the base time and at the test time, no further analysis is necessary of changes in individual interests.

### ***Shares held by clearinghouses***

18. We have been advised that in the United States of America, shares in listed public companies are often held in the name of an entity that acts solely as a clearinghouse for the settlement of



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securities trades and as a custodian of securities. The provisions of Division 20 do not allow public companies and publicly traded unit trusts to look beyond this clearinghouse entity when using the notional holder rule to make their determinations under subsection 160ZZSA(2). To give the notional holder provisions their intended operation in relation to US shareholders, however, our practice under subsections 160ZZSC(2) and 160ZZSD(2) is to allow public companies and publicly traded unit trusts to apply the notional holder rule as if the clearinghouse entity were not the registered holder of shares.

19. In exercising the powers in subsections 160ZZSC(2) and 160ZZSD(2) we accept that public companies and publicly traded unit trusts may treat shares registered in the name of the clearinghouse as if they were registered to the clients that are recorded in the records of the clearinghouse entity. If the clearinghouse entity is answerable to the client for shares that carry the right to receive less than 1 per cent of any distribution of capital of a public company, or the right to receive less than 1 per cent of any dividends that the company may pay, those shares may be treated as being held by the notional holder referred to in subsection 160ZZSM(2) or 160ZZSM(3).

20. Public companies and publicly traded unit trusts that can establish by using this method that the majority underlying interests in their pre-CGT assets have not changed, may rely on that result. Their pre-CGT assets will retain their pre-CGT status on the basis the Commissioner is satisfied, or considers it reasonable to assume, under subsection 160ZZSC(2) or 160ZZSD(2), that the same natural persons held the majority underlying interests in the assets at the base time and at the test time. In this limited situation there is no need to make application to the Commissioner. A public company or publicly traded unit trust will, of course, still have to apply to the Commissioner under subsection 160ZZSC(2) or 160ZZSD(2) if it cannot establish using this method alone, together with its other records of underlying interests, that the majority underlying interests in its pre-CGT assets have not changed and wishes to rely on additional evidence.

## Extended use of the special tracing rules

21. A public entity may be required under subsection 160ZZSC(4) to determine whether the same natural persons held the majority underlying interests in a pre-CGT asset at the base time and at some other time before 20 January 1997. Subsection 160ZZSC(4) applies if it would have been appropriate for the public entity to examine the underlying interests in a pre-CGT asset, having regard to the advice contained in Taxation Ruling IT 2361 or Taxation Ruling IT 2530.

22. A public company or publicly traded unit trust that is required to make a determination under subsection 160ZZSC(4) may use the special tracing rules, or any one or more of them, in making the determination. Our acceptance of the special tracing rules for this purpose will be reviewed if the proposed changes to Division 20 announced by the Treasurer on 12 May 1998 do not become law.

## **Date of effect**

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23. This Ruling has effect from 20 January 1997 and applies to the 1996-97 or a later income year. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

## **Explanations**

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### **Public entities to determine changes in majority underlying interests**

24. Section 160ZZSA directs a public entity to which it applies to examine its records (and 'its records' may include information the entity receives or that is available from related entities or other sources) and determine whether the same natural persons held the majority underlying interests in its pre-CGT assets at the base time and at a test time. A determination for the purposes of Division 20 is the result ascertained by a public entity from examining records of the underlying ownership of its assets. In other words, it is the public entity's conclusion, based on the records available to it, about whether the same natural persons held the majority underlying interests in its pre-CGT assets at the base time and at a test time.

25. A public entity should record its determination as evidence the determination was properly made. No form or procedure is prescribed in the law for making or recording a determination. To serve its purpose as evidence of a valid determination, however, a record of the determination should:

- show the conclusion the public entity arrived at;
- show the date on which the determination was made; and
- be signed by the public officer or another person authorised by the entity to make the determination.

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Having made and recorded its determination, a public entity should keep the documents together with the records on which it based its conclusions.

26. Being a result ascertained from records of the interests that natural persons hold, a determination under Division 20 cannot be based on assumptions (apart from assumptions provided for in the law). All information required to make the determination must be found in records available to the public entity. So, for example, an entity may only be able to identify 40 per cent of the underlying interests in its assets, but more than half of those identified interests had been held by the same natural persons at the base time and the test time. In this situation the entity cannot assume, based on the statistical evidence of the 40 per cent of interests it has identified, that more than half of the remaining 60 per cent of underlying interests have also been held by the same natural persons since the base time. A determination made on that basis would rest partly on an assumption, not wholly on the available records. Similarly, an entity cannot treat natural persons as having underlying interests if they do not have an interest recognised in law (including an interest referred to in section 160ZZRS or 160ZZRT) in the asset or in income derived from the asset.

27. A determination that is not based wholly on actual records of underlying interests, after making any assumptions that apply to the entity under Division 20, is not a valid determination. An entity that does not make a valid determination within the time allowed may be taken to have acquired its pre-CGT assets on 20 September 1985 or on another date determined under section 160ZZSB.

28. Assumptions that public entities must make, or are entitled to make, are specified in Division 20. The assumptions that relate to making a determination are:

- treating interests that pass to beneficiaries of a deceased person's estate as if they had been held at all times by the beneficiaries (section 160ZZRU);
- treating interests that were held at the base time by persons who cannot be identified as if they were not held by the same natural persons at the test time (subsection 160ZZSA(3));
- the notional holder rule in Subdivision E;
- the rules for tracing through interposed complying superannuation funds, complying approved deposit funds, special companies and government bodies (Subdivision F); and

- the rules for tracing interests held by an entity that was formerly a mutual insurance organisation (Subdivision G).

**Exercise by the Commissioner of the discretion under subsection 160ZZSC(2) or 160ZZSD(2)**

29. An examination of the records available to a public entity, after making any assumptions available to it under Division 20, may result in the public entity making a determination that the same natural persons had not continued to hold the majority underlying interests in its assets. The public entity may, however, have information that might satisfy the Commissioner that the same natural persons had held the majority underlying interests at the base time and the test time. In that case the entity may (after taking into account paragraphs 18 to 20 of this Ruling, which apply to shares held by certain clearinghouse entities) make an application under subsection 160ZZSC(2) or 160ZZSD(2).

30. It is not possible to outline all matters that might be relevant in considering an application under subsection 160ZZSC(2) or 160ZZSD(2). Each case has to be decided on its own merits. Matters that are often relevant to, but not necessarily determinative of, the way the discretion is exercised include:

***The time that has elapsed between the base time and the test time***

31. Majority interests may be eroded in the course of day-to-day trading of an entity's shares or units in the market or (for membership interests that are not transferable) in the course of the creation and cancellation of interests. The more trading, issues and cancellations occur, with the passage of time, the more likely it is that majority underlying interests may have changed. On the other hand, we recognise that not all trading of shares or units brings about a change, or a permanent change, of underlying interests.

32. The time that has elapsed between the base time and the test time needs to be considered in conjunction with a second matter for consideration:

***The extent of trading in, or creation and cancellation of, shares, units or other membership interests of the entity***

33. Information about the volume of normal day-to-day trading, creation and cancellation of interests in a public entity provides some indication of whether a majority of the membership interests might change hands. Any transactions outside the normal course of trading,

creation and cancellation of interests are also taken into account. For example, if over the period between the base time and the test time, a period of more than 10 years, there has been an annual 15% turnover in a company's shares, this may indicate there has been a change in majority underlying interests in the assets of the company.

***Known changes in underlying interests and the extent of the underlying interests that have been shown not to have changed***

34. In every case it is likely some underlying interests are known to have changed, and some are known not to have changed since 19 September 1985 and there are other interests that were held at the base time or the test time by persons who have not been identified, so that the public entity cannot show whether or not those interests have continued to be held by the same natural persons. In an application under subsection 160ZZSC(2) or 160ZZSD(2), the public entity needs to provide information to enable the Commissioner to be satisfied that more than 50% of the underlying interests in its pre-CGT assets - comprising the interests that are known not to have changed and some of the unidentified interests - have been held by the same natural persons since 19 September 1985.

35. If, for example, 45 per cent of the underlying interests in a public entity's pre-CGT assets are known not to have changed, and only 10 per cent are known to have changed, little further information might be needed to satisfy the Commissioner that the majority underlying interests are still held by the same natural persons. On the other hand, if 40 per cent of the underlying interests are known to have changed, and only 35 per cent are known not to have changed, more detailed information might be needed about the 25 per cent of underlying interests that are unidentified.

***Known changes in registered interests in the entity and the extent of the registered interests that are known not to have changed***

36. Because of the nature of certain entities that own shares, units or other membership interests, a public entity may be unable to identify a significant number of the underlying interests in its pre-CGT assets. This might be the case, for example, for entities that have a strong representation of overseas entities, nominees and the like among their memberships. In these circumstances, the Commissioner may be able to make assumptions about the likely extent of changes in underlying interests by comparing records of persons and entities that were registered owners of the entity's shares, units or other membership interests at the base time with similar records at the test time. Records showing the extent to which registered shareholders, unitholders or members have continued to

hold interests in the entity are not a conclusive factor, but are taken into account in the light of all available information.

***The nature and identity of registered shareholders, unitholders or members of the public entity***

***The nature and identity of registered shareholders, unitholders or members of an interposed entity***

37. Certain classes of persons who hold interests in public entities are more likely than others to hold those interests for long periods. Some become shareholders, unitholders or members of large public entities to secure a regular income, or as a form of superannuation. At the opposite end of the spectrum, some persons - who may hold more substantial interests - tend to acquire those interests to serve short term objectives. According to the extent to which each class of persons holds interests in pre-CGT assets of a public entity, it may be possible to make reasonable inferences about the length of time for which certain underlying interests are likely to have been held.

38. Where interests in the pre-CGT assets of a public entity are held indirectly through one or more interposed companies or trusts, the public entity may have difficulty discovering which of the interests have had the same beneficial owners over a long period of time. In this situation we may be able, using information about the average length of time interests are held through companies or trusts of that kind, to estimate how likely it is that some of the interests have been beneficially held by the same natural persons since the base time.

***The extent of efforts made to identify underlying interests***

***The reasons why further tracing of underlying interests cannot or will not be carried out***

***The likelihood that further attempts to trace, if they were made, would be successful in identifying underlying interests***

39. An entity that applies for a discretion to be exercised should do everything it reasonably can to establish there is a genuine need for the discretion to be exercised and to construct a sound basis for its exercise. In particular cases there might be good reasons why entities decide it would be pointless or unjustifiable to attempt to trace further. It may be that, because of the nature or location of particular shareholders, unitholders or members, further tracing would be difficult. Or there may be some prospect that further tracing would be successful, but at a high cost. Circumstances of these kinds, along with the other factors mentioned in this section of the Ruling, are taken into account in exercising the discretion.

***The state of records held, and the reasons for any deficiency in the records***

40. To compare the natural persons who held the underlying interests in their pre-CGT assets at the base time and at a test time, public entities need to have created and retained certain records. Some entities may have destroyed relevant records for the period from 1 July 1985 to 30 June 1986 (in which the base time occurs), or failed to compile the necessary records. The Commissioner takes into account the reasons for any lack of records that may affect the public entity's ability to identify the underlying interests in its assets.

41. Sometimes, a deficiency in records may arise because a public entity and another entity that is interposed between the public entity and natural persons who hold interests in its assets have chosen different base times. The public entity is unable to use in a determination under subsection 160ZZSA(2) the records of underlying interests that the interposed entity compiled as at its base time. However, in deciding whether to exercise the discretion in subsection 160ZZSC(2) or 160ZZSD(2), we may accept the interposed entity's records as sufficient evidence of underlying interests at the public entity's base time, unless there appears to have been a substantial change in underlying interests between the two base times.

***The rationale for any exercise of a discretion under the 1936 Act or under the 1997 Act in relation to a public entity, or in relation to an entity that is related to the public entity, where the beneficial ownership of shares or units in the public entity was considered in exercising the discretion******Details of any examination of beneficial ownership by the public entity, or by an entity that is related to the public entity, for the purposes of any provision of the 1936 Act or the 1997 Act***

42. When a company attempts to satisfy the requirements of section 80A of the 1936 Act or Subdivision 166-F of the 1997 Act to enable a loss to be deducted from its assessable income, the examination of beneficial ownership is similar, although not identical, to the examination required under Division 20 of Part IIIA in respect of beneficial interests. There are also other provisions of the Acts, including, for example, the provisions relating to bad debts, losses incurred by trusts and capital losses, under which beneficial interests may be examined. Records and information considered under any of these provisions under which beneficial interests are examined, and the decision taken in respect of the provision, may throw light on whether there has been a continuity of underlying interests from the base time to a test time.

***The extent of trading in, or creation and cancellation of, shares, units or other membership interests of entities interposed between the public entity and holders of underlying interests in its assets***

43. Where an entity is interposed between a public entity and the natural persons who hold the underlying interests in its assets, it is relevant to take into account available information about transactions in the shares, units or memberships of the interposed entity.

***Any other matter that is relevant in the circumstances of the particular case***

44. Public entities should not limit the information they provide in an application under subsection 160ZZSC(2) or 160ZZSD(2) to the matters listed in this Ruling. When considering an application, we take into account any matter relevant to an exercise of the discretion in the circumstances of the particular case. An entity should state, fully and in detail, the grounds for the application, including all information it has that:

- (a) might indicate the same natural persons have or have not continued to hold certain underlying interests; or
- (b) could assist us in drawing inferences on a reasonable basis about the extent to which underlying interests have or have not continued to be held by the same natural persons.

For example, we take into account any statistical information about the known ownership of shares in a listed public company or units in a publicly traded unit trust that is reasonably capable of being applied to an unknown shareholding in the company or unitholding in the trust.

45. We take the view that in exercising the discretion under subsection 160ZZSC(2) or 160ZZSD(2), the Commissioner should not take into account subsection 160ZZSA(3), which in certain circumstances treats the underlying interests in an asset as having been held by different natural persons at the base time and at the test time.

**Reliance on the special tracing rules when applying for the discretion to be exercised**

46. At each test time at which Division 20 applies to a public entity, the entity must make a determination showing whether the majority underlying interests in its pre-CGT assets were held by the same natural persons who held the majority underlying interests at the base time. If the public entity is a public company or publicly traded unit trust, it may make the determination using the special tracing



rules in Subdivisions E, F and G of Division 20. Using these rules the public company or publicly traded unit trust may:

- treat shareholder interests of less than 1 per cent in a public company or unitholder interests of less than 1 per cent in a publicly traded unit trust as if they were held by a single natural person, known as the notional holder;
- treat certain funds or special companies with more than 50 members, and government bodies, as if the fund, special company or government body were a natural person holding interests for its own benefit;
- treat underlying interests held through funds or special companies with 50 or fewer members as if they were held by those members in equal proportions; and
- make certain assumptions about interests held through a public company or publicly traded unit trust that had ceased to be a mutual insurance organisation between the base time and a particular test time.

47. A public company or publicly traded unit trust that makes a determination showing the majority underlying interests in its pre-CGT assets were not held by the same natural persons at the base time and at the test time may apply to the Commissioner to exercise the discretion under subsection 160ZZSC(2) or 160ZZSD(2). Often, a company or trust that asks for the discretion to be exercised has adopted one or more of the special tracing rules in examining the majority underlying interests in its assets. For example, individual interests of less than 1 per cent may have been treated as having been held collectively by a notional holder at the base time and at the test time; or the underlying interests in shares or units held by a complying superannuation fund or approved deposit fund with more than 50 members may have been assumed not to have changed.

48. In making a case for consideration under subsection 160ZZSC(2) or 160ZZSD(2), a public company or publicly traded unit trust may ask us to rely on the special tracing rules and, where relevant, on the concession we have made for shares held by clearinghouses. If the Commissioner is satisfied, or considers it reasonable to assume, from the information supplied that the same natural persons held the majority underlying interests in a pre-CGT asset of the company or trust at the base time and at the test time, no further analysis is necessary of changes in individual interests.

***Shares held by clearinghouses***

49. We have been advised that in the United States of America, shares in listed public companies are often held in the name of an entity that acts solely as a clearinghouse for the settlement of securities trades and as a custodian of securities. An example of such an entity is The Depository Trust Company which, through its nominee Cede & Co, holds shares and other instruments chiefly for bankers and brokers. According to our understanding, shares are registered in the name of the clearinghouse only to enable automated post-trade processing services to be provided for shares traded on behalf of its clients and to reduce the physical movement of share certificates.

50. Because of the large numbers of shares this kind of entity holds in its custodial role, public companies and publicly traded unit trusts are extremely restricted in their use of the notional holder rule where their shares, or shares of a company that holds an interest in their assets, are listed on a US stock exchange. The restriction arises from a characteristic of the trading on those exchanges - in particular, the use of entities set up to perform a clearinghouse and custodial function. The effect of structures of this kind was not foreseen when the notional holder provisions were included in Division 20.

51. To give the notional holder provisions their intended operation in relation to US shareholders, our practice is to allow public companies and publicly traded unit trusts to apply the notional holder rule as if the clearinghouse entity were not the registered holder of shares. In exercising the powers in subsections 160ZZSC(2) and 160ZZSD(2) we accept that public companies and publicly traded unit trusts may treat shares registered in the name of the clearinghouse as if they were registered to the clients that are recorded in the records of the clearinghouse entity. If the clearinghouse entity is answerable to the client for shares that carry the right to receive less than 1 per cent of any distribution of capital of a public company, or the right to receive less than 1 per cent of any dividends the company may pay, those shares may be treated as being held by the notional holder referred to in subsection 160ZZSM(2) or subsection 160ZZSM(3).

52. This concession can only be made in exercising the powers in subsection 160ZZSC(2) or 160ZZSD(2). It is not available for the purpose of making a determination under subsection 160ZZSA(2).

53. A public company or publicly traded unit trust must, therefore, first make a determination under subsection 160ZZSA(2) on the footing that the clearinghouse entity is the registered holder of the shares in its custody. If the public company or trust is unable to show on this basis that the continuity of majority underlying interests in its pre-CGT assets has been maintained, it should then apply the notional holder rule as described in paragraph 51 to shares registered in the

name of the clearinghouse. Public companies and trusts that can establish by using that method that the majority underlying interests in the pre-CGT assets have not changed, may rely on that result. Their pre-CGT assets will retain their pre-CGT status on the basis the Commissioner is satisfied, or considers it reasonable to assume, under subsection 160ZZSC(2) or 160ZZSD(2), that the same natural persons held the majority underlying interests in the assets at the base time and at the test time. In this limited situation there is no need to make application to the Commissioner.

54. If a public company or publicly traded unit trust cannot establish that there has been no change in majority underlying interests by relying on records of underlying interests and on the special tracing rules (including the notional holder concession outlined in paragraphs 51 to 53 of this Ruling), but wishes to take other information into account that might assist in showing there has been no change, the public company or trust must make an application to the Commissioner for exercise of the powers in subsection 160ZZSC(2) or 160ZZSD(2). The Commissioner will take into account the role of clearinghouse entities in US stock market trading when considering those applications.

### **Extended use of the special tracing rules**

55. Division 20 provides for special tracing rules to be available, at the option of a public company or publicly traded unit trust, for the purpose of subsection 160ZZSA(2) in determining the natural persons who held underlying interests in the company's or trust's pre-CGT assets at the base time and at the test time. There are, however, other dates at which, under Division 20, public entities may need to examine the underlying interests in their pre-CGT assets. Subsection 160ZZSC(4) requires a public entity to identify the earliest day on which it was required in practice to examine the underlying interests in its pre-CGT assets before 20 January 1997, having regard to relevant public rulings (Taxation Rulings IT 2361 and IT 2530) and on which it is unable to show that the majority underlying interests had been maintained.

56. We do not require public companies and publicly traded unit trusts to use different rules in examining the underlying interests in their pre-CGT assets under subsection 160ZZSC(4) than they used to make a determination under subsection 160ZZSA(2). A public company or publicly traded unit trust required to make a determination under subsection 160ZZSC(4) may use the special tracing rules, or any one or more of them, in making the determination. Our acceptance of the special tracing rules for this purpose will be reviewed if the proposed changes to Division 20 announced by the Treasurer on 12 May 1998 do not become law.

## **Effect of Taxation Rulings IT 2361 and IT 2530**

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57. Subsection 160ZZSC(4) in Division 20 refers to the way Taxation Rulings IT 2361 and IT 2530 applied before 20 January 1997. Subsection 160ZZSC(4) requires ‘public entities’ to determine whether, having regard to section 160ZZS and either of those Rulings, it would have been appropriate for them to have examined the underlying interests in their pre-CGT assets. If a particular entity should have examined the underlying interests in its pre-CGT assets, and the entity is unable to show that at that time the majority underlying interests were held by the same natural persons who held the majority underlying interests at the base time, the assets are taken to have been acquired at that time.

58. In the past, there have been different views about some aspects of Taxation Rulings IT 2361 and IT 2530. Views have been put forward about what the Rulings meant when they referred to ‘normal transactions’ in the shares of a public company or the units of a publicly traded unit trust. There have been questions about how wide the classes of entities are that were affected by each of the Rulings.

### **Classes of entities covered**

59. In our view, all ‘public entities’ were covered by Taxation Rulings IT 2361 and IT 2530. The Rulings indicated that the Commissioner would be satisfied in respect of two classes of entities, referred to as ‘public companies’ and ‘publicly traded unit trusts’, that majority underlying interests in their pre-CGT assets had been maintained except when there was activity in the nature of a takeover or merger, or there were other major changes in the ownership of shares or units outside the conduct of normal trading in the shares or units, or when additional shares or additional units were issued. These Rulings did not provide any protection from administrative action for all other entities which were required by section 160ZZS to examine continually the underlying interests in their pre-CGT assets.

60. Taxation Ruling IT 2361, in referring to ‘public companies’, meant those public companies whose shares are traded on a stock exchange. This intention can be seen from paragraph 4 of the Ruling, which distinguishes normal transactions in a company’s shares on a stock exchange from major changes in ownership of shares that occur outside the conduct of normal stock market trading. There was no discussion in the Ruling of an exemption for companies whose shares are not normally traded on a stock exchange. The Ruling was only intended to give a concession to listed public companies.

61. This interpretation of the Ruling is consistent with Taxation Ruling IT 2530, which made parallel arrangements for certain unit trusts. It expressly defines a unit trust to which it applies as a unit trust 'the units in which are listed for quotation in the official list of a stock exchange in Australia or elsewhere, or are ordinarily available for subscription or purchase by the public'.

62. It follows that the Rulings, in a practical sense, relieved listed public companies and publicly traded unit trusts from the obligation to monitor normal stock market transactions in their shares or units, or to monitor normal subscriptions or purchases of units in the case of certain publicly traded unit trusts, so long as they were not associated with activity in the nature of a takeover or merger. Issues of additional shares or additional units and other major changes that occurred outside the conduct of normal market trading still needed to be examined.

63. There was some guidance in paragraph 9 of Taxation Ruling IT 2530 for companies in which a listed public company or publicly traded unit trust has a direct or indirect interest.

### **Companies that are owned by other public entities**

64. The definition of 'public company' in section 160ZZRR includes as a public company for the purposes of Division 20:

- '(a) ...
- (b) a company (other than a listed public company) all the shares in which are beneficially owned by any one or more of the following:
  - (i) listed public companies;
  - (ii) mutual insurance organisations;
  - (iii) publicly traded unit trusts; or
- (c) a 100% subsidiary of a company to which paragraph (b) applies'.

Most companies that are public companies under paragraph (b) or paragraph (c) would previously have looked to paragraph 9 of Taxation Ruling IT 2530 for guidance as to what would satisfy the Commissioner that there was no change in the majority underlying interests. Paragraph 9 advised a company to assume that each listed public company or publicly traded unit trust that held its shares, or had an indirect interest in its shares, had maintained a continuity in the majority underlying interests in its own assets, so long as there had only been normal transactions in the public company's shares or the trust's units and these transactions were not associated with activity in the nature of a takeover or merger.

65. One purpose of paragraph 9 of Taxation Ruling IT 2530 was to relieve companies from the need to monitor the underlying interests in their pre-CGT assets continually if they had been wholly owned, directly or indirectly, by the same listed public company or publicly traded unit trust since before 20 September 1985. They only needed to examine the underlying interests when the listed public company or publicly traded unit trust examined the underlying interests in its own assets. This concession applied to companies that fall within paragraph (b) of the definition of ‘public company’ in which all the shares are beneficially owned by a single listed public company or a single publicly traded unit trust, and companies within paragraph (c) that are 100% subsidiaries of these companies.

66. The practical effect of paragraph 9, therefore, was that these wholly-owned companies should have determined whether there had been a change in the majority underlying interests in their assets when there was activity in the nature of a takeover or merger, or other major changes in the ownership of the shares or units outside the conduct of normal trading, or any issue of additional shares or additional units, in the parent listed public company or publicly traded unit trust. Subsection 160ZZSC(4) now requires a public entity to identify the earliest day on which it was required to determine the majority underlying interests in its pre-CGT assets and on which it is unable to show that majority underlying interests had been maintained. For these wholly-owned companies, that day is the same day the parent company or trust identifies for its own assets.

67. Different issues arise for companies that fall within paragraph (b) of the definition of ‘public company’ and the shares in which are beneficially owned by more than one listed public company, mutual insurance organisation or publicly traded unit trust. The application of subsection 160ZZSC(4) to these companies needs to be considered on a case by case basis.

### ***When did obligations arise under the Rulings?***

68. Taxation Ruling IT 2361 issued on 18 September 1986 and Taxation Ruling IT 2530 issued on 4 May 1989. Subsection 160ZZSC(4) requires public entities to make a determination for a date earlier than 20 January 1997 where it would have been appropriate for them to do so under a ruling given by the Commissioner. To avoid any inconsistency in the way subsection 160ZZSC(4) applies to listed public companies and publicly traded unit trusts, only events in the nature of a takeover or merger, issue of additional shares or additional units, or other major transaction, which occurred after 4 May 1989 are treated as triggering a test time requiring a listed public company or publicly traded unit trust to examine the underlying interests in its assets. If the public company

or trust is required to make an examination it must take into account all changes of underlying interests that took place between 19 September 1985 and the test time.

## **The meaning of ‘normal transactions’**

69. Subsection 160ZZSC(4) applies to a company or trust only if it was appropriate, having regard to the Rulings, for the company or trust to examine the majority underlying interests in its pre-CGT assets.

70. Paragraph 4 of Taxation Ruling IT 2361 advised taxpayers that a listed public company need not examine the majority underlying interests in its pre-CGT assets for the purposes of section 160ZZS as long as there were only normal transactions in its shares on a stock exchange that were not associated with activity in the nature of a takeover or merger. It went on:

‘Major changes in the ownership of shares which occur outside the conduct of normal stock market trading, however, will call for careful examination, in the course of which regard will be paid to changes in shareholdings that have occurred in the course of normal trading on stock exchanges as well as to those related to the events that caused the examination to be made.’

Paragraph 5 of Taxation Ruling IT 2530 provided similar advice in relation to publicly traded unit trusts.

71. Paragraph 6 of Taxation Ruling IT 2530 explained how the Rulings applied to the issue of additional units in a unit trust or additional shares in a listed public company. It advised that these were not to be treated as part of the normal trading of units or shares.

72. It follows that if there was any transaction associated with activity in the nature of a takeover or merger, or any major change in the ownership of shares or units that was outside the conduct of normal trading, or any issue of additional shares or additional units, then the listed public company or publicly traded unit trust was required by law to make an examination of the majority underlying interests in its pre-CGT assets.

73. An alternative view has been argued that the Rulings should be read as requiring the underlying interests to be examined only where there were transactions in a company’s shares or a trust’s units related to a takeover or merger or that there was no need to examine underlying interests unless there were ‘major changes’ of ownership, whether in the market or through issues of additional shares or units.

**Normal transactions under subsection 160ZZSC(4)**

74. In our view the Rulings indicated that listed public companies and publicly traded unit trusts continued to be required to examine the majority underlying interests in their pre-CGT assets in circumstances where there was:

- trading in the company's shares or trust's units that was related to an attempted takeover or merger (whether or not it was successful);
- any issue of new shares or units, including under a dividend reinvestment plan or by way of a bonus issue;
- any buy-back of shares or units or capital reduction; or
- any other major transaction in the company's shares or the trust's units that did not take place on a stock exchange, or (if the units in a particular publicly traded unit trust are not traded on a stock exchange) any major transaction outside the normal course of subscriptions, purchases and cancellations of units.

75. Subdivision D of Division 20 recognises there have been considerable changes in the way shares and units are traded or new shares and units are issued. In sections 160ZZSF to 160ZZSI in Subdivision D there are new tests for deciding what is abnormal trading that are more flexible than the rules in Taxation Rulings IT 2361 and IT 2530.

76. Before Division 20 was enacted, our view was that section 160ZZS required a listed public company or publicly traded unit trust to examine the majority underlying interests in its pre-CGT assets if there was any transaction in its shares or units associated with a takeover or merger, any major change in the ownership of its shares or units that was outside the conduct of normal trading, or any issue of additional shares or additional units. However, for the purposes of subsection 160ZZSC(4), we do not insist on an examination of the majority underlying interests where the particular transaction would not have been 'abnormal trading' if Subdivision D of Division 20 had been in force at that time. As a result, subsection 160ZZSC(4) is taken to apply to listed public companies and publicly traded unit trusts if both:

- (a) the company or trust, having regard to the Rulings, should have examined the underlying interests in its assets at a time before 20 January 1997; and
- (b) the transaction in its shares or units that took place at that time was 'abnormal trading' under Division 20.

77. As a further concession, we also accept for the purposes of subsection 160ZZSC(4) that a listed public company or publicly



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traded unit trust was not required to examine the majority underlying interests in its pre-CGT assets when:

- (a) the company or trust issued bonus shares or units, so long as all shareholders or unitholders were offered a number of shares or units in proportion to their existing holdings of ordinary shares in the company or units in the trust;
- (b) rights to acquire shares in the company or rights to acquire units in the unit trust are exercised, so long as all shareholders or unitholders were offered a number of rights in proportion to their existing holdings of ordinary shares in the company or units in the trust;
- (c) the company or trust issued shares or units under a dividend reinvestment plan, so long as all shareholders or unitholders were eligible to participate under the plan, and those shareholders or unitholders who chose to participate were offered a number of shares or units in proportion to their existing holdings of ordinary shares in the company or units in the trust; or
- (d) the company issued shares under an employee share acquisition scheme if the value of shares issued under the scheme in any year amounted to less than 5% of the company's existing issued share capital.

78. Changes in underlying interests that occur as a result of a transaction referred to in paragraph 77, however, need to be taken into account at any later time when the listed public company or publicly traded unit trust was not relieved under the Rulings from examining the underlying interests in its pre-CGT assets.

79. For publicly traded unit trusts the units in which were not traded on a stock exchange, the cancellation of units or issue of units to new applicants in the course of normal day-to-day operations is treated as being equivalent to the normal trading of units on a stock exchange, so long as the cancellation or issue of units was not:

- (a) associated with an attempted takeover or merger of the trust; or
- (b) done to enable the trustee to acquire property in its capacity as trustee of the trust.

## Detailed contents list

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*Related Rulings/Determinations:*

IT 2361; IT 2530

*Subject references:*

- abnormal trading
- approved deposit fund
- base time
- capital gains
- continuity of majority underlying interests
- cost base
- discretion
- government bodies
- merger
- mutual insurance organisations
- notional single shareholder or unitholder
- public company
- public entities
- publicly traded unit trusts
- special companies
- superannuation fund
- takeover
- test time
- tracing of ownership and interests
- tracing rules
- underlying ownership and interests

*Legislative references:*

- ITAA36 80A
- ITAA36 Pt IIIA Div 20
- ITAA36 160ZZRR
- ITAA36 160ZZRS
- ITAA36 160ZZRT
- ITAA36 160ZZRU
- ITAA36 160ZZSA
- ITAA36 160ZZSA(2)
- ITAA36 160ZZSA(3)
- ITAA36 160ZZSB
- ITAA36 160ZZSC(2)
- ITAA36 160ZZSC(4)
- ITAA36 160ZZSD(2)
- ITAA36 160ZZSF
- ITAA36 160ZZSI
- ITAA36 160ZZSJ
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- ITAA36 160ZZSP
- ITAA36 160ZZSQ
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- ITAA36 160ZZST
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*Case references:**ATO references:*

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