



Class Ruling

Income tax: conversion of The Bega Co-operative Society Limited to a company registered under the *Corporations Act 2001*

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❶ 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, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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

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

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 124-520 of *Income Tax Assessment Act 1997* (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 members of The Bega Co-operative Society Limited (Bega Co-op) who are:

- existing members in Bega Co-op who will be issued with shares when Bega Co-op is registered as a company under the *Corporations Act 2001* (the Corporations Act) under the arrangement as described, and who are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936 (Existing Members); and
- former members of Bega Co-op who acquire a right to participate in the conversion under paragraph 139(2)(b) of the *Co-operatives Act 1992* (NSW) (the Co-operatives Act) and are issued with shares when Bega Co-op is registered as a company under the Corporations Act, and who are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936 (Former Members).

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in the 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 13 to 26 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

8. This Ruling applies from 19 December 2007 to 30 June 2008. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling subject to there being no change in the scheme or in the entities involved in the scheme.

9. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. 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:

- application for Class Ruling from Radford & Co on behalf of Bega Co-op dated 30 August 2007;
- copy of the Draft Constitution of Bega Cheese Limited;
- rules of The Bega Co-operative Society Limited;
- correspondence received from Radford & Co on 5 November 2007 in response to our request for further information dated 17 October 2007; and

- further information provided by the applicant on 29 November 2007.

14. Bega Co-op is an entity incorporated under the Co-operatives Act.

15. Bega Co-op is owned by its members, most of whom are dairy farmers who actively supply milk to Bega Co-op. As a co-operative, Bega Co-op has three types of members:

- active members who supply milk or other dairy products to Bega Co-op;
- non-active members who have previously supplied milk to Bega Co-op but no longer do so.

Section 127 of the Co-operatives Act, in conjunction with the rules of the Co-op, requires the cancellation of the membership and forfeiture of shares of members who have not been active for two years. The amount paid up on the shares is repaid on forfeiture; and

- former Members who have had their shares forfeited by Bega Co-op.

Under section 139 of the Co-operatives Act, former members who have had their shares forfeited may acquire a right to be issued with shares in the converted company upon a conversion, if a special resolution is passed within five years of that date of forfeiture (Membership Interests).

16. There are more than 100 members of the Bega Co-op, and there is no single shareholding greater than 5%. There is no entity that, together with its associates, holds a direct or indirect interest of more than 40% in the Co-op.

17. The Board of Directors of Bega Co-op proposes to register Bega Co-op as a company under the Corporations Act. The proposal is to be approved by:

- the Registrar of Co-operatives; and
- the members by special resolution passed in accordance with the Co-operatives Act.

18. On obtaining the necessary approvals, application will be made to the Australian Securities and Investment Commission for Bega Co-op to be registered under the Corporations Act with a new name, Bega Cheese Limited (Bega Cheese), and a constitution approved by the members of Bega Co-op. Thereafter, Bega Co-op will cease to be registered as a co-operative.

19. Upon its registration as a company under the Corporations Act, Bega Cheese will issue two classes of shares:

- class A ordinary shares (Class A Shares) to active members; and

- class B ordinary shares (Class B Shares) to non-active members, and any former members who acquire the right to participate in the conversion.

20. The issue of the Class A and B Shares will so far as possible replicate the voting, dividend and winding up rights of the various categories of members in Bega Co-op.

21. In accordance with subsection 319(3) of the Co-operatives Act, the conversion of Bega Co-op from a co-operative to a company must result in every member who holds shares in the co-operative at the date of conversion being the holder of shares in the company equal in number and nominal value to their shares in the co-operative. The approximate amount standing in credit in the share capital account of the co-operative as at 30 August 2007 is \$22.5 million comprising 22.5 million issued shares with a par value of \$1.00 per share.

22. Upon the conversion, each Existing Member of the co-operative will be issued with Class A or Class B Shares equal in number to the number of shares held by them in Bega Co-op and paid up to \$1.00 each.

23. Former Members who acquire Membership Interests will be issued with Class B Shares. The maximum number of Class B Shares to be issued to Former Members on the exercise of these rights would be approximately 3.47 million.

24. To the extent that Former Members acquire rights to become shareholders in the company, the share capital account will be credited with the amounts repaid by Former Members; that is up to 3.47 million shares of \$1.00 each. This amount was paid to Former Members by Bega Co-op when their shares were forfeited.

25. The principal features of the proposed company Bega Cheese and the difference between it and Bega Co-op are as follows:

Class of shares

- Bega Co-op has one class of shares but two categories of members holding those shares (active and non-active).
- Bega Cheese will have two classes of shares:
 - Class A Shares held by active members; and
 - Class B Shares held by non-active members and Former Members who acquire the right to participate in the conversion.

Voting rights

- Active members of Bega co-op are currently able to vote at meetings of members of Bega Co-op, holding one vote each.

- Class A Shareholders of Bega Cheese will be entitled to vote at meetings of members of Bega Cheese, holding one vote per share.

This reflects the different treatment of voting rights under the Co-operatives Act and the Corporations Act.

Dividend rights

- As Bega Co-op has only one class of shares, dividends are declared equally regardless of whether a member is an active or a non-active member. Former Members are not entitled to receive dividends.
- Under the proposed Constitution of Bega Cheese, Class A Shareholders and Class B Shareholders (including Former Members) will have the same dividend rights.

Cessation of active membership

- A member of the Bega Co-op who becomes inactive is no longer entitled to vote under section 181 of the Co-operatives Act.
- Under the proposed Constitution of Bega Cheese, if a holder of a Class A Share ceases to be a supplier, the Class A Shares held may be converted to Class B (non-voting) Shares. Conversely, if a Class B Shareholder becomes a supplier, the shares may be converted into Class A Shares.

Buy back and cancellation of shares of inactive members

- An inactive member of the Bega Co-op will have their shares forfeited after two years and the share capital represented by the shares forfeited paid to the members.
- There will be no compulsory forfeiture provision in the proposed Constitution of Bega Cheese. Bega Cheese may, from time to time, conduct share buy backs to give the holders of Class B Shares the opportunity to exit their shareholdings.

26. The stated aims of the proposed conversion are:

- the retention of the co-operative attributes that underlie Bega Co-op;
- the creation of a permanent share capital base to support development and growth of the business;
- to preserve the active members' voting power in Bega Co-op on a one vote per share basis;
- the introduction of new milk suppliers; and

- to overcome the accounting treatment of co-operative shares as liabilities in accordance with the Australian International Financial Reporting Standards.

Ruling

Subdivision 124-I roll-over

27. Existing Members of Bega Co-op can choose roll-over under section 124-520 for the ending of their shares in Bega Co-op at the time of the conversion.

28. Former Members who are issued shares in Bega Cheese can choose roll-over under section 124-520 for the ending of their Membership Interests in Bega Co-op at the time of the conversion.

Value shifting provisions

29. For the Existing and Former Members of Bega Co-op, the arrangement involving the conversion of Bega Co-op to Bega Cheese is not one to which any of the consequences in Division 725 or Division 727 will apply.

Assessable dividend

30. The proposed conversion will not result in an assessable dividend, as defined in subsection 6(1) of the ITAA 1936 for the members who are within the class of entities mentioned in paragraph 3 of this Ruling.

Commissioner of Taxation

19 December 2007

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.*

Subdivision 124-I roll-over

31. Subdivision 124-I allows a member of a body that is incorporated under a law other than company law to choose roll-over for a CGT event that happens when the incorporated body converts to a company incorporated under the Corporations Act or a similar foreign law (Company Law). The conditions for roll-over are listed in subsection 124-520(1).

Conditions for roll-over – Existing Members

32. CGT event C2 in section 104-25 happens when an Existing Member's share in Bega Co-op ends on the conversion. Existing Members of Bega Co-op can claim roll-over under section 124-520 for the ending of their shares.

33. Paragraph 124-520(1)(a) requires that the entity choosing roll-over is a member of a body that is incorporated under a law other than Company Law.

34. This requirement is satisfied as the Bega Co-op is incorporated under the Co-operatives Act.

35. Paragraph 124-520(1)(b) requires that the body is converted into a company incorporated under Company Law (without creating a new legal entity). The Explanatory Memorandum to the Taxation Laws Amendment Bill 1990, which introduced former section 160ZZPH of the ITAA 1936, the predecessor to section 124-520, states, 'This requirement will ... usually be satisfied where a law under which the incorporation as a company is to occur specifically provides for the legal succession of the company as successor to the former entity.'

36. This condition is satisfied as the Bega Co-op is to be registered as a company under the Corporations Act. Under paragraph 601BM(1)(a) of that Act and subsection 321(1) of the Co-operatives Act, the incorporation does not create a new legal entity.

37. The condition in paragraph 124-520(1)(c) is satisfied as Bega Cheese will issue the members with shares (and nothing else) in substitution for their interest in the body just before the conversion. Each Existing Member of Bega Co-op will receive only shares in Bega Cheese in substitution for their Membership Interests in Bega Co-op.

38. Paragraph 124-520(1)(d) requires that there is no significant difference between:

- (i) the ownership of the body just before the conversion and the ownership of the company just after the conversion; or
- (ii) the mix of ownership of the body just before the conversion and the mix of the ownership of the company just after the conversion.

39. Subparagraph 124-520(1)(d)(i) is satisfied on the facts of this arrangement. Just before the conversion, the owners of Bega Co-op are the active and non-active members who hold shares in the Co-op, and the participating Former Members who hold Membership Interests in the Co-op.

40. Former Members acquire a Membership Interest in the Co-op when they satisfy all of the requirements to participate in the conversion under the terms of paragraph 139(2)(b) of the Co-operatives Act. These requirements are:

- the resolution under subsection 316(2) of the Co-operative Act to convert to a company is passed within five years of the time when the shares were forfeited; and
- the Former Member has satisfied the requirement in section 141 of the Co-operatives Act by repaying any forfeiture proceeds to the co-operative.

41. The owners of Bega Cheese just after conversion are the Existing Members and Former Members of Bega Co-op just before the conversion who are issued with shares on conversion.

42. Paragraph 124-520(1)(d)(ii) is also satisfied on the facts of this arrangement.

43. There are differences in the mix of ownership that occur as a result of the conversion. However, in view of the totality of the facts of this arrangement, involving the conversion of a widely held co-operative to a company registered under the Corporations Act, and the requirements of the different statutory regimes under which Bega Co-op and Bega Cheese are registered, these differences are not regarded as significant for the purpose of subparagraph 124-520(1)(d)(ii).

44. While the voting rights in both Bega Co-op and Bega Cheese are limited to active members, the active members of Bega Co-op receive one vote per member as required by subsection 176(1) of the Co-operatives Act, whereas they will receive one vote per share as members of Bega Cheese.

45. The admission of Former Members who acquire Membership Interests does not result in any change in the mix of ownership so as to cause a failure of subparagraph 124-520(1)(d)(ii). Bearing in mind the circumstances in which a participating Former Member's Membership Interest is acquired under the terms of paragraph 139(2)(b) of the Co-operatives Act, the character and ownership attributes of that interest are derived from the rights that the Membership Interest will secure. These are the rights that the participating Former Member will enjoy as a shareholder in Bega Cheese, rather than any rights that they had formerly enjoyed as shareholders in the Co-op prior to forfeiture.

46. Paragraph 124-520(1)(e) requires that, at the time of conversion, either the member is an Australian resident as defined in subsection 6(1) of the ITAA 1936 or the interest in the body for which roll-over is sought is taxable Australian property just before the time of conversion and the shares are taxable Australian property. The class of entities is limited in paragraph 3 of this Ruling to residents of Australia. Accordingly this requirement is satisfied.

Conditions for roll-over – Former Members

47. As explained in paragraph 15 of this Ruling, a Former Member who fulfils all of the requirements in the Co-operatives Act acquires a Membership Interest in Bega Co-op. The Membership Interest is acquired on the date when all of these requirements are satisfied.

48. The Membership Interest entitles the member to be issued with shares, equal in number and nominal value to their former shareholding in Bega Co-op.

49. CGT event C2 in section 104-25 happens when the Membership Interest ends on the issue of Class B Shares in Bega Cheese. Former Members of Bega Co-op can claim roll-over under section 124-520 for the ending of their Membership Interests.

50. The requirements in paragraphs 124-520(1)(b) and (d) are satisfied for the reasons stated in paragraphs 35 to 36 and 38 to 45 of this Ruling.

51. Former Members will satisfy the requirement in paragraph 124-520(1)(a) in that the person claiming roll-over relief is a 'member of the body' that is converting. Member is not defined and takes its meaning according to its context. In this case the term would include any person entitled to benefit in the event that the co-operative were wound-up or converted to a company. This would include those entities that satisfy the conditions referred to in paragraph 40 of this Ruling.

52. The condition in paragraph 124-520(1)(c), that the company issues the Former Member with shares (and nothing else) in substitution for their interest in the body just before the conversion, is satisfied as each Former Member receives only Class B Shares in substitution for the Membership Interests they hold just before conversion.

53. As with Existing Members, paragraph 124-520(1)(e) is satisfied as the class of entities to which this Ruling applies is limited to residents of Australia.

Consequences if Subdivision 124-I roll-over is chosen

54. The consequences of a choice being made to apply the roll-over in Subdivision 124-I are set out in Subdivision 124-A:

- For an Existing Member that holds shares in Bega Co-op acquired before 20 September 1985, new Class A and Class B Shares in the company that are issued are taken to be acquired before that day;
- For an Existing Member that holds shares in Bega Co-op acquired on or after 20 September 1985, a capital gain or capital loss made on the ending of those shares is disregarded, and the first element of the cost base and reduced cost base of the new Class A and Class B Shares in the company is worked out by apportioning the cost base and reduced cost base of the shares that have ended; and
- For a participating Former Member, a capital gain or capital loss made on the ending of their Membership Interest rights is disregarded, and the first element of the cost base and reduced cost base of the new Class B Shares in Bega Cheese is worked out by apportioning the cost base and reduced cost base of the Membership Interests that have ended.

The first element of the cost base of the Membership Interests includes the amount of any forfeiture proceeds repaid to the Bega Co-op: paragraph 110-25(2)(a).

Value shifting consequences

55. There can be capital gains tax and 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.

56. 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.

57. The indirect value shifting rules in Division 727 do not apply unless the entities between which value is shifted (the losing entity 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.

58. There are no consequences for any direct value shift or indirect value shift that happens under the arrangement involving the conversion of Bega Co-op to Bega Cheese. There would be no consequences for any direct value shift as there is no entity that controls (for value shifting purposes) Bega Co-op or (when converted) 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 that provides economic benefits to Bega Cheese, or receives such economic benefits in return, would, together with Bega Co-op or (when converted) Bega Cheese meet the ultimate controller test or common-ownership nexus test: paragraphs 727-100(c) and 727-110(1)(a), sections 727-105 and 727-355.

Assessable dividend

59. Subsection 6(1) of the ITAA 1936 defines 'dividend' for the purposes of the income tax legislation to include:

- (a) any distribution made by a company to any of its shareholders, whether in money or other property; and
- (b) any amount credited by a company to any of its shareholders as shareholders.

However, paragraph (d) of the definition within subsection 6(1) excludes any distribution which is debited against the share capital account of a company, except where subsection 6(4) applies.

60. Subsection 6(4) of the ITAA 1936 provides that paragraph (d) of the definition of 'dividend' in subsection 6(1) does not apply if, under an arrangement, a company raises share capital from one taxpayer which is credited to its share capital account, and then distributes that amount which has been credited to the share capital to another taxpayer.

61. In this case, the issue of additional Class B Shares will not constitute a dividend, as it will not involve either a distribution of money or property of the company to the shareholders or an amount being credited by the company to any of its shareholders as shareholders.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

- assessable income
- bonus equities
- capital gain
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- control test
- co-operative company
- distribution
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- ITAA 1997 124-520(1)(d)(i)
- ITAA 1997 124-520(1)(d)(ii)
- ITAA 1997 124-520(1)(e)
- 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
- Copyright Act 1968
- Corporations Act 2001
- Corporations Act 2001 601BM(1)(a)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Co-operatives Act 1992 (NSW) 127
- Co-operatives Act 1992 (NSW) 139
- Co-operatives Act 1992 (NSW) 139(2)(b)
- Co-operatives Act 1992 (NSW) 141
- Co-operatives Act 1992 (NSW) 176(1)
- Co-operatives Act 1992 (NSW) 316(2)
- Co-operatives Act 1992 (NSW) 319(3)
- Co-operatives Act 1992 (NSW) 321(1)

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 6(4)
- ITAA 1936 160ZZPH
- ITAA 1997 104-25
- ITAA 1997 110-25(2)(a)
- ITAA 1997 Subdiv 124-A
- ITAA 1997 Subdiv 124-I
- ITAA 1997 124-520
- ITAA 1997 124-520(1)
- ITAA 1997 124-520(1)(a)
- ITAA 1997 124-520(1)(b)
- ITAA 1997 124-520(1)(c)
- ITAA 1997 124-520(1)(d)

Other references:

- Explanatory Memorandum to the Taxation Laws Amendment Bill 1990

ATO references

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ATOLaw topic: Income Tax ~~ Assessable income ~~ dividend, interest and royalty income
 Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 - end of a CGT asset
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