Class Ruling

Income tax: Wesfarmers Limited – demerger of Coles Group Limited – employee share schemes

Contents Para

Summary – what this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below 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 the Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 44 of the ITAA 1936
- Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997)
- subsection 104-75(1) of the ITAA 1997
- section 104-135 of the ITAA 1997
- section 106-50 of the ITAA 1997
- subsection 110-25(2) of the ITAA 1997
- section 112-20 of the ITAA 1997

- section 112-115 of the ITAA 1997
- section 115-5 of the ITAA 1997
- section 115-25 of the ITAA 1997
- subsection 115-30(1) of the ITAA 1997
- Division 125 of the ITAA 1997
- subsection 130-80(4) of the ITAA 1997
- section 130-85 of the ITAA 1997
- Division 230 of the ITAA 1997
- section 977-50 of the ITAA 1997
- subsection 995-1(1) of the ITAA 1997.

Legislative references in this Ruling are to provisions of the ITAA 1936 or to provisions of the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is employees of Wesfarmers Limited (Wesfarmers) (or its subsidiaries) who:

- were, from the time they acquired their Wesfarmers shares until after the demerger mentioned in paragraph 10 of this Ruling, employed by one or more entities within only one of
  - Wesfarmers and its subsidiaries, other than the Coles Group (continuing Wesfarmers employees), or
  - the Coles Group, being Coles Group Limited (Coles) and the entities that were subsidiaries of Coles just after the demerger (Coles employees)
- held Wesfarmers shares acquired under one of the following Wesfarmers Employee Share Scheme Plans on 22 November 2018 (the Record Date)
  - Wesfarmers Employee Shares Acquisition Plan (WESAP), or
  - Wesfarmers Long Term Incentive Plan (WLTIP)
- are residents of Australia within the meaning of section 6(1) on the Record Date
- are not temporary residents within the meaning of subsection 995-1(1)
- did not hold their shares in Wesfarmers as revenue assets (as defined in section 977-50) nor as trading

stock (as defined in subsection 995-1(1)) on the Record date, that is, they held their shares on capital account, and

- are not subject to the taxation of financial arrangements in Division 230 in relation to gains and losses on their Wesfarmers shares.

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

4. In this Ruling, a person belonging to this class of entities is referred to as a 'Participant'.

Qualifications

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

6. 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 20 of this Ruling.

7. 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.

Date of effect

8. This Ruling applies from 1 July 2018 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 *Public rulings*).

Scheme

9. The following description of the scheme is based on information provided by the applicant.

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

10. The scheme that is the subject of this Ruling involves the demerger by Wesfarmers of Coles by way of an in specie distribution (the Distribution) to Wesfarmers shareholders of shares in Coles on 28 November 2018 (the Implementation Date).

The Distribution

11. Wesfarmers is an Australian resident public company listed on the Australian Securities Exchange (ASX) and the head company of an income tax consolidated group for the purposes of Part 3-90.

12. Before the Distribution, Wesfarmers' business operations covered supermarkets, liquor sales, hotels and convenience stores, home improvement, office supplies, department stores, and an industrial division with businesses in chemicals, energy and fertilisers, industrial and safety products and coal.

13. Immediately before the Distribution, Coles was a wholly owned subsidiary of Wesfarmers via Wesfarmers Retail Holdings Pty Ltd (WRH) and a member of the Wesfarmers income tax consolidated group. At that time, WRH owned all of the shares in Coles.

14. Prior to the Distribution, Wesfarmers undertook a number of group restructuring activities to transfer the ownership of interests in businesses not forming part of the restructuring accomplished by the Distribution. The entities subject to the latter restructuring are the Coles subsidiaries which own the supermarkets, liquor sales, hotels and convenience store businesses of Wesfarmers and the property holding companies.

15. On the Implementation Date, Wesfarmers paid WRH an amount comprising a reduction of share capital (the capital reduction amount) and a dividend declared by the directors of Wesfarmers (which the shareholders of Wesfarmers were entitled to), as consideration for the Distribution, being the transfer by WRH of 85% of the shares in Coles to the shareholders of Wesfarmers. WRH retained 15% of the shares in Coles.

16. The capital reduction amount was calculated by reference to the relative market values of Coles and Wesfarmers at that time. The amount of the dividend (the dividend component of the Distribution) was the difference between the market value of the Distribution and the capital reduction amount.

17. Shareholders, including Participants, received one Coles share for each Wesfarmers share they held on the Record Date.

Employee Share Schemes

18. Participants holding a beneficial interest in allocated Wesfarmers shares, acquired under the WESAP, WLTIP or WESAP Tax Exempt Plan and held by the Wesfarmers Employee Share Trust (the WEST), are entitled to receive one Coles share for each beneficial interest held by the Participant in the Wesfarmers share. On the Implementation Date, immediately after the Distribution, the Coles shares were transferred to those Participants.
Certain Participants with a large number of allocated Wesfarmers shares will be subject to an ASX trading lock on their Coles shares once transferred.

19. The WESAP and WLTIP operate as follows:

- shares allocated under the WESAP and WLTIP are fully-paid ordinary shares in Wesfarmers
- Wesfarmers shares allocated to eligible employees are subject to genuine trading restrictions
- allocated Wesfarmers shares are held in the WEST on behalf of the Participant during the trading restriction period
- Participants can choose to leave their Wesfarmers shares in the WEST after the trading restriction period, and
- while a Wesfarmers share is held in the WEST on behalf of a Participant, the Participant is entitled to receive dividends and other benefits in relation to their allocated Wesfarmers share.

WESAP Tax Exempt Plan

20. Wesfarmers shares acquired under the WESAP Tax Exempt Plan are subject to Subdivision 83A-B and meet the conditions in section 83A-35.

Ruling

No ESS deferred taxing point for Participants

21. The Distribution will not cause an ESS deferred taxing point under section 83A-115 in respect of Wesfarmers shares held by the WEST for Participants.

WESAP Tax Exempt Plan – entitlement to $1,000 reduction

22. Following the Distribution, Participants continue to be entitled to reduce, under section 83A-35, the amounts included in their assessable income in relation to the Wesfarmers shares acquired under the Tax Exempt Plan, provided the plan continues to be operated so that the conditions in subsection 83A-45(4) are satisfied.

Coles shares are not ESS interests

23. The Coles shares acquired by Participants as a result of the Distribution are not ESS interests provided under an employee share scheme within the meaning of subsection 83A-10(2).

Dividend component of the Distribution is not assessable income or exempt income

24. The dividend component of the Distribution is not assessable or exempt income (subsection 44(4)).

CGT consequences

CGT event G1

25. CGT event G1 (section 104-135) happened at the time the payment of the capital reduction amount was satisfied by way of an in specie distribution of a Coles share to a Participant in respect of a Wesfarmers share that they are taken to have owned (subsections 130-85(2) and 106-50(1)) at the Record Date and continued to own at the Implementation Date.

Capital gain

26. Participants will make a capital gain from CGT event G1 happening if the capital reduction amount for each Wesfarmers share is more than the cost base of the Wesfarmers share. If so, the capital gain is equal to the amount of the excess. No capital loss can be made from CGT event G1 (Note 1 to subsection 104-135(3)).

Demerger roll-over

27. A demerger, as defined in section 125-70, happened to the Wesfarmers demerger group (which included Wesfarmers and Coles) under the scheme described in paragraphs 9 to 20 of this Ruling.

28. Therefore, Participants can choose to obtain demerger roll-over under section 125-55 for their Wesfarmers shares.

Consequences of choosing demerger roll-over

29. For Participants who choose demerger roll-over:

- any capital gain made when CGT event G1 happened to their Wesfarmers shares under the demerger is disregarded (subsection 125-80(1)), and
- it is necessary to recalculate the first element of the cost base and reduced cost base of their Wesfarmers shares, and calculate the first element of the cost base and reduced cost base of the corresponding Coles shares they acquired under the demerger (subsection 125-80(2)).

30. The first element of the cost base and reduced cost base of each Wesfarmers share and corresponding Coles share just after the demerger is worked out by:

- taking the total of the cost bases of the Wesfarmers shares just before the demerger (see paragraphs 34 to 38 of this Ruling), and
- apportioning that total between the Wesfarmers shares and the Coles shares acquired under the demerger.

31. The apportionment of this total is done on a reasonable basis having regard to the market values (just after the demerger) of the Wesfarmers shares and Coles shares, or an anticipated reasonable approximation of those market values (subsection 125-80(2)) and 125-80(3)).

32. The Commissioner accepts that a reasonable apportionment is to:

- attribute 71.09% of the total of the cost bases of the Wesfarmers shares just before the demerger to the Wesfarmers shares, and
- attribute 28.91% of the total of the cost bases of the Wesfarmers shares just before the demerger to the corresponding Coles shares.

Consequences of not choosing demerger roll-over

33. Participants who do not choose demerger roll-over:

- cannot disregard any capital gain made when Coles event G1 happened to their Wesfarmers shares under the demerger, and
- must recalculate the first element of the cost base and reduced cost base of their Wesfarmers shares, and calculate the first element of the cost base and reduced cost base of the corresponding Coles shares they acquired under the demerger, in the same way as described in paragraphs 30 to 32 of this Ruling (subsections 125-85(1) and (2)).

Cost base of Wesfarmers shares just before the demerger

34. Where a Participant's Wesfarmers share relates to an ESS interest that is subject to Subdivision 83A-B (that is, the discount on acquisition of the interest is included in the assessable income of the Participant in the income year it was acquired) the first element of the cost base and reduced cost base of the share at the time it was granted to the Participant is its market value at that time (subsections 83A-30(1) and 110-25(2)).

35. Where a Participant's Wesfarmers share relates to an ESS interest that is subject to Subdivision 83A-C (that is, a gain in the value of the interest is included in the assessable income of the Participant on a deferred basis), the cost base and reduced cost base of the share just before the Distribution depends on whether the Distribution happens before or after the ESS deferred taxing point for the share.

36. Where the Distribution occurs after the ESS deferred taxing point for the share, the first element of its cost base and reduced cost base will be its market value immediately after the ESS deferred taxing point (section 83A-125, section 112-15 and subsections 110-25(2) and 110-55(2)).

37. The amount of the first element of the cost base and reduced cost base may have been subsequently affected by events (for example, a return of capital) that have occurred between the time the ESS interest was granted and the Implementation date.

38. Where the Distribution occurs before the ESS deferred taxing point for the share, the first element of its cost base and reduced cost base will be nil, as the Participant acquired the share for nil consideration, and the market value substitution rule (section 112-20) does not apply (subsection 130-80(4)).

Acquisition time of Coles shares for CGT discount purposes

39. Whether or not a Participant choses roll-over, a Coles share they received under the Distribution is taken to have been acquired when their corresponding Wesfarmers share was acquired for the purpose of establishing whether 12 months has elapsed between the acquisition of the share and a CGT event that subsequently happens to the share, which is one of the conditions for the Participant to be entitled to a discount capital gain for the event (sections 115-5 and 115-25; subsection 115-30(1), item 2 of the table; section 112-115, item 14C of the table).

40. Where a Participant's Wesfarmers share relates to an ESS interest that is subject to Subdivision 83A-B, the time of acquisition of the Participant's corresponding Coles share will be the date the ESS interest was granted to the Participant (section 83A-30 and subsection 109-5(1)).

41. Where a Participant's Wesfarmers share relates to an ESS interest that is subject to Subdivision 83A-C, the time of acquisition of the share as at the time of the Distribution depends on whether or not the ESS deferred taxing point for the share has been reached at the time of the Distribution.

42. Where the Distribution occurs after the ESS deferred taxing point for the share, the Participant's Coles share, for CGT discount purposes, will be taken to have been acquired immediately after the ESS deferred taxing point for the Participant's corresponding Wesfarmers share (section 83A-125).

43. Where the Distribution occurs before the ESS deferred taxing point, the acquisition time of a Participant's Coles share, for CGT discount purposes, will be the time when the Trustee of WEST allocated the corresponding Wesfarmers share to the Participant (subsections 130-85(2), 106-50(1) and 109-5(1)). The acquisition time is unaffected by the occurrence of the subsequent ESS deferred taxing point.

CGT event E5

44. CGT event E5 does not happen when the Participant is allocated the Coles shares.

Commissioner of Taxation
14 December 2018

Appendix 1 – Explanation

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.

ESS deferred taxing point

45. Section 83A-115 provides that the 'ESS deferred taxing point', if the ESS interest is a beneficial interest in a share, is the earliest of:

- the earliest time when
  - there is no real risk of forfeiting or losing the ESS interest, and
  - any disposal restrictions which existed at the time the ESS interest was acquired no longer apply
- when the employment in respect of which the ESS interest was acquired ends, or
- the end of the 15 year period starting when you acquired the interest.

46. As none of these occurred at the time of the Distribution for a Participant, the Distribution does not cause an ESS deferred taxing point at that time in respect of Participants' Wesfarmers shares.

WESAP Tax Exempt Plan – entitlement to $1,000 reduction

47. Section 83A-35 provides that where:

- ESS interests acquired by an individual under an employee share scheme at a discount satisfy the conditions in subsections 83A-35(6) and (7) and in section 83A-45, and
- the individual's taxable income for the income year plus the other amounts specified in paragraph 83A-35(1)(b) does not exceed $180,000

the total amount included in the individual's assessable income under subsection 83A-25(1) for an income year (being discounts in relation to ESS interests acquired during the income year) is reduced by the total of the amounts included under that subsection for the income year in relation to those ESS interests, up to a limit of $1,000.

48. Subsection 83A-45(4) requires that the scheme under which an individual acquires their ESS interests be operated so that any acquirer of an ESS interest under the scheme is not permitted to dispose of the scheme interest during the minimum holding period.

49. Subsection 83A-45(5) provides that the minimum holding period is the earlier of:

- three (3) years from the date of acquisition of the ESS interest, or
- cessation of employment within the meaning of section 83A-330.

50. As the disposal restrictions under the WESAP Tax Exempt Plan continue to apply to Wesfarmers shares acquired by continuing Wesfarmers and Coles employees under the plan, the conditions in subsection 83A-45(4) will continue to be satisfied.

51. Accordingly, Participants who acquired Wesfarmers shares under the WESAP Tax Exempt Plan remain entitled to the reduction described in paragraph 47 of this Ruling in respect of those shares.

Coles shares are not ESS interests provided under an employee share scheme

52. An ESS interest is acquired under an employee share scheme only if the ESS interest is acquired in relation to the employee's employment (subsection 83A-10(2)).

53. Under the Distribution, the Coles shares were available to all Wesfarmers shareholders. Accordingly, the distribution to Participants was not a result of their employment, but as a consequence of their existing interest in the Wesfarmers shares.

Dividend component of the Distribution is not assessable income or exempt income

54. The dividend referred to in paragraphs 15 and 16 of this Ruling is a demerger dividend, as defined in subsection 6(1). Therefore, a Participant's share of the dividend is not included in their assessable income and is not assessable income or exempt income (subsections 44(3) and (4)).

CGT consequences

Absolute entitlement

55. When a Participant is allocated a Wesfarmers share held in WEST, the Participant is treated as being absolutely entitled as against the Trustee of WEST to the relevant Wesfarmers share for the purposes of Division 83A, Part 3-1 and Part 3-3 until they no longer have a beneficial interest in the share (subsection 130-85(2)). From just after that time, Parts 3-1 and 3-3 apply to the share as if it is the Participant's share (subsection 106-50(1)).

CGT event G1

56. When Wesfarmers paid the return of capital, CGT event G1 happened to the Participant in respect of each Wesfarmers share allocated to them of which the Trustee of WEST was the registered shareholder on the Record Date and which continued to be held by the Trustee at the Implementation Date (section 104-135).

57. The Participant will only make a capital gain if the return of capital is more than the cost base of the Wesfarmers share (subsection 104-135(3)). The amount of the capital gain is equal to the excess. There can be no capital loss from the event. Because the event happened because of a demerger, the cost base and reduced cost base of the share is adjusted under subsections 125-80(2) and (3) rather than under subsection 104-135(3) or (4) (see paragraphs 30 to 32 and 59 of this Ruling).

Demerger roll-over

58. A resident owner of ownership interests in the head entity of a demerger group may choose to disregard a capital gain or capital loss made as a result of a CGT event that happens to those ownership interests under a demerger where the owner receives new or replacement interests in the demerged entity (section 125-55).

59. Participants may choose the roll-over as:

- they are resident
- they are deemed, for capital gains tax purposes, to own Wesfarmers shares (see paragraph 55 of this Ruling)
- Wesfarmers was the head entity of a demerger group just before the Distribution
- a demerger (as defined in subsection 125-70(1)) happened to that demerger group, and
- under the demerger, CGT event G1 happened to Wesfarmers shares and Participants received Coles shares.

60. For the purpose of working out the cost base and reduced cost base apportionment under subsections 125-80(2) and (3) (see paragraphs 30 to 32 of this Ruling), the Commissioner accepts the volume weighted average prices of the Coles shares, $12.8459, and of the Wesfarmers shares, $31.5848, as traded on the ASX on a deferred settlement basis over the first five trading days from (and including) 21 November 2018, as a reasonable approximation of the relative market value of those shares.

Cost base of Wesfarmers shares just before the demerger

61. Where a Participant's Wesfarmers share relates to an ESS interest that is subject to Subdivision 83A-B and the Participant's Wesfarmers share was granted before the return of capital paid by Wesfarmers in 2013 and 2014, the cost base of the share will have been reduced under CGT event G1 as specified in paragraph 63 of Class Ruling CR 2013/69 *Income tax: Return of capital: Wesfarmers Limited* and paragraph 145 of Class Ruling CR 2014/76 *Income Tax: Capital management distribution: Wesfarmers Limited*.

62. Where a Participant's Wesfarmers share relates to an ESS interest that is subject to Subdivision 83A-C and the ESS deferred taxing point for the Wesfarmers share occurred before the return of capital mentioned in paragraph 61 of this Ruling, the cost base of the Wesfarmers share will have been reduced by CGT event G1 (refer to paragraph 61 of this Ruling).

CGT event E5

63. CGT event E5 happens if a beneficiary becomes absolutely entitled to a trust asset (section 104-75).

64. The Participant is entitled to receive all the dividends and other benefits (including return of capital) that accrue in respect of the allocated Wesfarmers shares. Accordingly, CGT event E5 does not happen when the Participant is allocated the Coles shares.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2013/69; CR 2014/76;
TR 2006/10

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1997
- ITAA 1997 Div 83A
- ITAA 1997 Subdiv 83A-A
- ITAA 1997 83A-10(2)
- ITAA 1997 Subdiv 83A-B
- ITAA 1997 83A-25(1)
- ITAA 1997 83A-30
- ITAA 1997 83A-30(1)
- ITAA 1997 83A-35
- ITAA 1997 83A-35(1)(b)
- ITAA 1997 83A-35(6)
- ITAA 1997 83A-35(7)
- ITAA 1997 83A-45
- ITAA 1997 83A-45(1)
- ITAA 1997 83A-45(4)
- ITAA 1997 83A-45(5)
- ITAA 1997 Subdiv 83A-C
- ITAA 1997 83A-115
- ITAA 1997 83A-125
- ITAA 1997 Subdiv 83A-E
- ITAA 1997 83A-330
- ITAA 1997 104-75(1)
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 106-50
- ITAA 1997 106-50(1)
- ITAA 1997 109-5(1)
- ITAA 1997 110-25(2)
- ITAA 1997 110-55(2)
- ITAA 1997 112-15
- ITAA 1997 112-20
- ITAA 1997 112-115
- ITAA 1997 115-5
- ITAA 1997 115-25
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- ITAA 1997 125-55
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- ITAA 1997 125-80(2)
- ITAA 1997 125-80(3)
- ITAA 1997 130-80(4)
- ITAA 1997 125-85(1)
- ITAA 1997 125-85(2)
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- ITAA 1997 130-85(2)
- ITAA 1997 Div 230
- ITAA 1997 977-50
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ATO references

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