

# ***CR 2001/5 - Income tax: capital gains: scrip for scrip roll-over: acquisition of Medical Monitors Pty Ltd by Defiance Mining NL***



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## Class Ruling

Income tax: capital gains: scrip for scrip  
roll-over: acquisition of Medical Monitors Pty  
Ltd by Defiance Mining NL

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### *Preamble*

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

## What this Class Ruling is about

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

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

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

- Subdivision 124-M (Scrip for scrip roll-over); and
- section 104-25 (CGT event C2); and
- Division 116 (Capital proceeds).

### **Class of persons**

3. The shareholders and optionholders of Medical Monitors Pty Ltd (‘MM’) who enter into the proposed Share Sale and Subscription Agreement (on the same terms as the draft 3 dated 14.3.2001) in accordance with which Defiance Mining NL (‘Defiance’) will acquire all of the shares and options in MM and in return will issue a combination of ordinary shares and converting preference shares for every MM share acquired and will issue options for every MM option acquired.

## Qualifications

4. Scrip for scrip roll-over is not available under section 124-780 for interests in a company that were acquired prior to 20 September 1985 (paragraph 124-780(3)(a)). This Ruling does not apply to shares or options in MM that were acquired for CGT purposes before that date.

5. Scrip for scrip roll-over is only available for interests that, apart from the roll-over, would have given rise to a capital gain on a CGT event happening in relation to them (paragraph 124-780(3)(b)). This Ruling does not apply to shares or options in MM that would not give rise to a capital gain on disposal to Defiance.

6. Special rules apply for the purposes of scrip for scrip roll-over if an original interest holder is a significant stakeholder for an arrangement. In determining whether an entity has a significant stake in another entity, interests held by associates are taken into account (section 124-783). This Ruling is made on the basis that none of the shareholders in MM is an associate just before the arrangement commences or if there are associates, the 30% stake threshold is not met for any MM shareholder.

7. Scrip for scrip roll-over is not available if any capital gain from a replacement interest might be disregarded – except because of a roll-over (paragraph 124-795(2)(a)). This Ruling does not apply to shares or options if capital gains from the replacement interests in Defiance might be so disregarded.

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

9. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraph 13 to 23 is carried out in accordance with the details of the arrangement provided in this Ruling.

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

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

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## **Date of effect**

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12. This Class Ruling applies to years of income commencing both before and after its date of issue.

## **Arrangement**

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13. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- application for the class ruling dated 9 March 2001 in relation to the proposed acquisition of Medical Monitors Pty Ltd by Defiance Mining NL; and
- proposed Share Sale and Subscription Agreement (draft 3 dated 14.3.2001); and
- further correspondence from Deloitte Touche Tohmatsu dated 21 March 2001, 23 March 2001 and 26 March 2001.

**Note: certain information received from Defiance Mining NL and Deloitte Touche Tohmatsu has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information Legislation.**

14. Defiance will acquire 100% of the shares and options in MM in accordance with a proposed Share Sale and Subscription Agreement (on the same terms as the draft 3 dated 14.3.2001) entered into between both of those companies and all of the shareholders of MM.

15. Under the agreement Defiance will issue a combination of ordinary shares and converting preference shares for every MM share held and will issue a combination of options for every MM option held.

16. Each MM shareholder will receive ordinary shares and 'Class A', 'Class B' and 'Class C' converting preference shares in proportion to their current shareholding. The converting preference shares will

convert to a set number of ordinary shares on satisfaction of the conditions outlined below.

17. The 'Class A' converting preference shares will convert to a set number of ordinary shares upon:

- (a) execution of a joint venture agreement between MM and its US joint venture partner regarding the joint venture in the USA; and
- (b) receipt by MM of a written opinion from its US joint venture partner that it believes that the projections excluding Ancillary Reserves in MM's business plan for the financial years 2002 and 2003 are achievable with respect to projected revenues and expenses.

18. 'Class B' and 'Class C' converting preference shares will convert to a set number of ordinary shares if MM achieves specified revenue targets by particular dates.

19. If the requirements for conversion are not met the converting preference shares will be redeemed or cancelled.

20. Every MM optionholder will receive 'Class A', 'Class B', 'Class C' and Class 'D' options in proportion to their current option holdings. Each class of options will have different rights.

21. 'Class A' options may be exercised immediately.

22. 'Class B' options may be exercised only upon:

- (a) execution of a joint venture agreement between MM and its US joint venture partner regarding the joint venture in the USA; and
- (b) receipt by MM of a written opinion from its US joint venture partner that it believes that the projections excluding Ancillary Reserves in MM's business plan for the financial years 2002 and 2003 are achievable with respect to projected revenues and expenses.

23. 'Class C' and 'Class D' options may be exercised only if MM achieves specified revenue targets by particular dates.

## Ruling

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24. Subject to the qualifications in paragraphs 4 to 11 of this Ruling, the shareholders and optionholders of MM may choose in accordance with paragraph 124-780(3)(d) to obtain scrip for scrip roll-over under section 124-780 in respect of the disposal to Defiance of their MM shares and options and the issue to them of Defiance shares and options.

25. No CGT event will happen if the converting preference Defiance shares are later converted into ordinary Defiance shares without being redeemed or cancelled.

26. If the requirements for conversion are not met and the converting preference Defiance shares are redeemed or cancelled, CGT event C2 in section 104-25 (about cancellation, surrender and similar endings of intangible CGT assets) will happen. The capital proceeds will be determined under Division 116.

## **Explanations**

### **Availability of scrip for scrip roll-over**

#### ***Replacement interest requirement - subsections 124-780(1),(4) and (5)***

27. Roll-over is available if a share in a company is exchanged for a share in another company. Similarly, roll-over is available if an option in one company is exchanged for an option in another company. There is no requirement that the shares or options carry the same kinds of rights and obligations unless subsection 124-780(4) applies.

28. Paragraph 2.25 in the explanatory memorandum ('EM') accompanying the *New Business Tax System (Capital Gains Tax) Bill* 1999, states

*'This requirement will be satisfied if a share in a company is exchanged for a share in another company... **even** if the rights attaching to the share... **are different**.'* (emphasis added)

29. Further, example 2.5 in the EM demonstrates that full scrip for scrip roll-over is available if ordinary shares are exchanged for a combination of ordinary and preference shares.

30. Subsection 124-780(4) will not apply in this case. It applies if the original interest holder and the acquiring entity did not deal at arm's length and one of the following is satisfied:

- (a) neither the original entity nor the replacement entity was widely held just before the arrangement started; or
- (b) the original interest holder, and the original and acquiring entities were members of the same linked group just before that time.

31. Regardless of whether Defiance and the MM shareholders and optionholders are dealing at arm's length paragraph 124-780(4)(a) will not apply because Defiance has more than 300 members just before the arrangement started (with the twenty largest Defiance shareholders

having less than 75% of the interests in the company). Paragraph 124-780(4)(b) cannot apply because Defiance and MM are not members of a linked group just before the arrangement started.

***Requirements regarding the arrangement - paragraph 124-780(1)(b) and subsection 124-780(2)***

32. Paragraph 124-780(1)(b) and subsection 124-780(2) require that the shares and options are exchanged in consequence of a single arrangement:

- that results in the acquiring entity (Defiance) becoming the owner of at least 80% of the voting shares in the original entity (MM); and
- in which all of the owners of voting shares in MM are able to participate; and
- in which participation is available on substantially the same terms for all interest holders of a particular type.

33. These conditions are satisfied because Defiance will acquire all of the shares and options in MM in accordance with the proposed Share Sale and Subscription Agreement referred to in paragraph 13. Under that draft agreement the consideration payable to each MM shareholder and optionholder is to be in proportion to their existing holding in MM.

***Other requirements in subsection 124-780(3)***

34. Paragraph 124-780(3)(a) provides that roll-over is only available for interests that were acquired by MM shareholders and optionholders on or after 20 September 1985. This Ruling is qualified in respect of this requirement: see paragraph 4.

35. Paragraph 124-780(3)(b) restricts roll-over to interests that would otherwise have given rise to a capital gain. This Ruling is qualified in respect of this requirement: see paragraph 5.

36. Paragraph 124-780(3)(c) requires that shareholders and optionholders seeking roll-over must receive replacement interests in the acquiring entity or its ultimate holding company. This requirement is satisfied because all replacement interests will be in Defiance which is not a 100% subsidiary of an ultimate holding company.

37. Paragraph 124-780(3)(d) provides that roll-over is available for an interest holder that is a *significant* or *common stakeholder* only if the replacement entity (Defiance) jointly elects for roll-over.

38. An interest holder is a significant stakeholder for an arrangement if it had a significant stake (30%) in the original entity before the arrangement and in the replacement entity after the arrangement: subsection 124-783(1). Alternatively, if the acquiring entity for an arrangement is an original interest holder in the original entity before the arrangement, its associates may be significant stakeholders: subsection 124-783(2).

39. As the largest shareholder in MM has, without consideration of interests of associates, a less than a 30% shareholding and on the basis that interests of any associates do not cause the 30% threshold to be met (see paragraph 6) there is no significant stakeholder under subsection 124-783(1) for this arrangement. As Defiance is not an original interest holder in MM just before the arrangement there is no significant stakeholder under subsection 124-783(2).

40. No interest holder is a *common stakeholder* for an arrangement if either the original entity or the replacement entity had at least 300 members just before the arrangement started: subsection 124-783(5). As Defiance had more than 300 members just before the arrangement (and the twenty largest Defiance shareholders have less than 75% of the interests in the company) there is no common stakeholder for this arrangement.

### ***Exceptions in section 124-795***

41. Scrip for scrip roll-over is not available if an exception in section 124-795 applies. As both Defiance and MM are incorporated in Australia both are Australian resident entities. The exceptions in subsections 124-795(1),(4) and (5) therefore will not apply.

42. The exception in paragraph 124-795(2)(a) may apply if for example the replacement interests in Defiance are trading stock. This Ruling is qualified in this regard by paragraph 7.

43. None of the other exceptions in paragraph 124-795(2)(b) or subsection 124-795(3) could apply in this case.

### **CGT consequences if the preference shares automatically convert to ordinary shares on satisfaction of the various conditions**

44. In accordance with Taxation Ruling TR 94/30, the mere conversion of the converting preference Defiance shares into ordinary Defiance shares will not give rise to a CGT event.

45. Paragraph 8 of TR 94/30 provides that

‘A variation in rights attaching to a share..... does not result in a full disposal of an asset for the purposes of Part IIIA unless there is a cancellation or redemption of the share. ....it is not



relevant to consider whether the variation is slight (such as a small change to the nominal value of shares) or more significant (such as disposing of the preference to receive dividends).

46. Similarly, paragraph 9 of TR 94/30 goes on to provide that the variation does not amount to a part disposal. Example 4 of the Ruling illustrates that there are no CGT consequences from the mere conversion of converting preference shares to ordinary shares.

### **CGT consequences if the converting preference shares are redeemed or cancelled**

47. CGT event C2 in section 104-25 will happen if the converting preference shares are redeemed or cancelled. A capital gain arises from CGT event C2 if the capital proceeds are more than the cost base of the shares. A capital loss arises from CGT event C2 if the capital proceeds are less than the reduced cost base of the shares.

48. If the market value substitution rule in section 116-30 applies to determine the capital proceeds received in respect of the redemption or cancellation of the converting preference Defiance shares, subsection 116-30(3A) provides that the market value is determined as if the redemption or cancellation had not occurred and was never proposed to occur.

49. The market value substitution rule will apply if the actual capital proceeds for redemption or cancellation of the shares are more or less than the market value of the shares at the time of CGT event C2 (see subparagraph 116-30(2)(b)(ii)).

50. As explained in Taxation Determination TD 10 taxpayers can choose to obtain a valuation from a qualified valuer or compute their own valuation. If it is considered appropriate the ATO may challenge a valuation.

## **Detailed contents list**

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**Commissioner of Taxation**

11 April 2001

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<i>Previous draft:</i>	- ITAA 1997 104-25
Not previously issued in draft form	- ITAA 1997 Div 116
	- ITAA 1997 116-30
<i>Related Rulings/Determinations:</i>	- ITAA 1997 116-30(3A)
TR94/30; TD10	- ITAA 1997 116-30(2)(b)(ii)
	- ITAA 1997 Subdivision 124-M
<i>Subject references:</i>	- ITAA 1997 124-780
- CGT event	- ITAA 1997 124-780(1)
- CGT event C2	- ITAA 1997 124-780(1)(b)
- company	- ITAA 1997 124-780(3)
- converting preference share	- ITAA 1997 124-780(3)(a)
- interests	- ITAA 1997 124-780(3)(b)
- option	- ITAA 1997 124-780(3)(c)
- optionholder	- ITAA 1997 124-780(3)(d)
- ordinary share	- ITAA 1997 124-780(4)
- original interest	- ITAA 1997 124-780(4)(a)
- preference share	- ITAA 1997 124-780(4)(b)
- replacement interest	- ITAA 1997 124-780(5)
- rights	- ITAA 1997 124-783
- scrip	- ITAA 1997 124-783(1)
- scrip for scrip	- ITAA 1997 124-783(2)
- share	- ITAA 1997 124-783(5)
- shareholder	- ITAA 1997 124-795
	- ITAA 1997 124-795(1)
	- ITAA 1997 124-795(2)(a)
	- ITAA 1997 124-795(2)(b)
<i>Legislative references:</i>	- ITAA 1997 124-795(3)

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- ITAA 1997 124-795(4)
- ITAA 1997 124-795(5)

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