


CR 2002/21 - Income tax: Listed investment companies: LIC capital gain: proposed disposal of investment portfolio of CMG CH China Investments Limited

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Class Ruling

Income tax: Listed investment companies:
LIC capital gain: proposed disposal of
investment portfolio of CMG CH China
Investments Limited

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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**, **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' identified below applies to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law dealt with in this Ruling is Subdivision 115-D of the *Income Tax Assessment Act 1997* ('ITAA 1997').

Class of persons

3. The class of persons to whom this Ruling applies is the shareholders of CMG CH China Investments Limited ('China Investments') who:

- (i) are individuals, complying superannuation entities, trusts or partnerships; or
- (ii) are life insurance companies where the dividend is in respect of shares that are virtual PST assets; and

are residents of Australia within the meaning of section 6 of the *Income Tax Assessment Act 1936* ('ITAA 1936') when a dividend is paid out of gains made on the disposal of China Investments' portfolio

of equity investments ('Investment Portfolio') under the 'Sale and Purchase' clause of the Asset Acquisition Agreement ("China Investments Sale Agreement") dated 4 December 2001.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 9 to 15 is carried out in accordance with the details of the arrangement provided in this Ruling.
6. 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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The Manager
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Date of effect

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

Arrangement

9. 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:

- (a) Letter dated 25 February 2002 from Allens Arthur Robinson requesting the ATO to make a Class Ruling in relation to a dividend paid to shareholders of a listed investment company out of gains made on the disposal of the investment portfolio of China Investments;
 - (b) China Investments' Annual Report 2001;
 - (c) Letter dated 4 December 2001 from China Investments to the Australian Stock Exchange advising of a signed agreement, subject to shareholder approval to restructure the Company;
 - (d) China Investments' Asset Acquisition Agreement.
10. China Investments has an Investment Portfolio consisting of shares, receivables and cash. Under the proposed arrangement, China Investments will sell its Investment Portfolio to Bermuda (Far East) Limited, in its capacity as trustee of the New Era PRC Fund ('the HK Fund'). The sale is being undertaken as part of the process of winding up China Investments and distributing the assets to its shareholders.
11. The purchase price payable by the HK Fund will be a number of units in the HK Fund with an aggregate issue price equal to the Net Asset Value of the Investment Portfolio (as determined by an independent valuer).
12. The sale of China Investments' assets to the HK Fund is subject to shareholder and regulatory approval.
13. Following completion of the sale of the Investment Portfolio, China Investments will distribute the HK Fund Units to its shareholders in proportion to their shareholdings. The distribution will be made by way of:
- (a) an equal reduction of capital effected by returning to shareholders assets of the company (principally consisting of the UK Fund Units); and
 - (b) a dividend from the available profits with payment also to be by way of the distribution of the HK Fund Units.
14. Under the arrangement to which this ruling applies:
- China Investments is an Australian resident company listed on the official list of the Australian Stock Exchange;
 - China Investments business activities entail the holding and managing of a portfolio of investments consisting of shares, receivables and cash;
 - China Investments became a listed investment company ('LIC') prior to 1 July 2001 and the market

value of its investments in shares has, since it became a LIC, continuously accounted for more than 90% of the market value of its CGT assets;

- A proportion of the assets that comprise the Investment Portfolio (including assets for which the capital proceeds from the sale will exceed the cost base) was acquired by China Investments, when it was a LIC, more than 12 months before the date on which the Investment Portfolio will be taken to have been disposed of by China Investments under the capital gains tax provisions;
- China Investments has not entered into and will not enter into any arrangement to extend the period of ownership of any asset to meet the requirement that assets be held for 12 months;
- China Investments will not elect to claim indexation in calculating any capital gains that it makes on the disposal of the CGT assets comprising the Investment Portfolio;
- China Investments has not held equity interests (directly or indirectly) in any other company or trust of more than 10%;
- The directors of China Investments will proceed to take all necessary steps to liquidate China Investments after the disposal of the Investment Portfolio.

15. An assumption advised by China Investments in respect of this arrangement is that China Investments will make an overall net gain from the sale of its Investment Portfolio. In respect of a significant number of shares in the Investment Portfolio, the capital proceeds that China Investments will receive from the sale of those shares will exceed the cost base of those shares (ignoring indexation). Based on this assumption, China Investments will make a net gain from the disposal of its Investment Portfolio, and the net capital gain will be included in its taxable income.

Ruling

16. Subject to the qualifications in paragraphs 4 to 6 of this Ruling, Australian resident shareholders of China Investments who are within the class of persons to whom this Ruling applies when a dividend is paid by China Investments out of gains made on the disposal of its Investment Portfolio to the HK Fund are entitled to a

deduction for their share of the attributable part of the dividend paid in accordance with subsection 115-280(2) of the ITAA 1997.

Explanations

Availability of deduction

17. Subdivision 115-D of the ITAA 1997 contains a number of requirements for a shareholder to be entitled to a deduction for their share of the attributable part of a dividend paid from a LIC. Below is an outline of the main conditions that are relevant to the circumstances of the arrangement that is the subject of this Ruling.

18. For a taxpayer to be entitled to a deduction for their share of the attributable part of the dividend paid from a LIC, the requirements of subsection 115-280(1) of the ITAA 1997 have to be satisfied.

19. Paragraphs 115-280(1)(a) and 115-280(1)(b) specify which shareholders of a LIC are entitled to a deduction for a LIC capital gain.

20. A shareholder is entitled to a deduction for a LIC capital gain if the shareholder is:

- (i) an individual;
- (ii) a complying superannuation entity (as defined in section 995-1(1) of the ITAA 1997);
- (iii) a trust or a partnership; or
- (iv) a life insurance company where the dividend is in respect of shares that are virtual PST assets; and

the shareholder of the LIC is an Australian resident (as defined in subsection 6(1) of the ITAA 1936 when the dividend is paid.

21. The amount allowed as a deduction to eligible shareholders is specified in subsection 115-280(2).

22. If you are an individual, a trust (except a trust that is a complying superannuation entity) or a partnership, you can deduct 50% of the share of the attributable part of the dividend worked out in accordance with subsection 115-280(3). The attributable part of the dividend is the LIC capital gain amount.

23. If you are a complying superannuation entity or a life insurance company where the dividend is in respect of shares that are virtual PST assets, you can deduct 33 1/3% of the share of the attributable part worked out in accordance with subsection 115-280(3). The attributable part of the dividend is the LIC capital gain amount.

24. Subsection 115-280(3) states how the attributable part of the dividend is worked out.

25. A formula is provided to enable a LIC to work out the attributable part. This formula requires the LIC to determine the part of the original LIC capital amount included in its taxable income for the income year.

26. Paragraph 115-280(1)(c) requires that all or some of the dividend is attributable to a LIC capital gain made by a LIC.

27. The meaning of a LIC capital gain is specified in section 115-285 of the ITAA 1997 and the meaning of a LIC is stated in section 115-290 of the ITAA 1997.

Meaning of a LIC capital gain – section 115-285

28. Paragraph 115-285(1)(a) states that a LIC capital gain is a capital gain from a CGT event that happens on or after 1 July 2001.

29. China Investments will dispose of its Investment Portfolio subject to certain exceptions to the HK Fund after 1 July 2001. The equities of China Investments are CGT assets as defined in section 108-5 of the ITAA 1997 and the disposal of each of the equities is a CGT event.

30. The equities were acquired on a Listed Stock Exchange and will be disposed of to the HK Fund under an agreement for sale. Therefore, CGT event A1 applies when each of the equities is disposed of as there is a change in ownership of a CGT asset under section 104-10 of the ITAA 1997.

31. In respect of a significant number of the listed shares in its Investment Portfolio, the capital proceeds that China Investments will receive from the disposal of these shares under subsection 116-20(1) of the ITAA 1997 will exceed the cost bases of those shares as defined in subsection 110-25(1) of the ITAA 1997. China Investments will therefore make a capital gain from the disposal of those shares pursuant to subsection 104-10(4).

32. China Investments will not make an election under subsection 110-25(8) to index the elements of the cost base specified in subsections 110-25(1) to 110-25(6).

33. The gains made on the disposal of the Investment Portfolio of China Investments to the HK Fund are not income according to ordinary concepts under section 6-5 of the ITAA 1997. Therefore, subsection 118-20(1) of the ITAA 1997 does not apply to reduce the amount of the net capital gain included in the assessable income of China Investments.

34. China Investments is disposing of all of its Investment Portfolio to the HK Fund (except for certain specified assets which will be used to meet outstanding liabilities such as taxation liabilities). Following the disposal of its Investment Portfolio the directors of China Investments will take all necessary steps to liquidate the company. Therefore, any gains made on the disposal of investments will be on capital account and not income according to ordinary concepts. The decision in *FC of T v. Equitable Life and General Insurance Co. Ltd.*; *Equitable Life and General Insurance Co. Ltd. v. FC of T* 90 ATC 4438 supports this view.

35. Paragraph 115-285(1)(c) states that the requirements of sections 115-20 and 115-25 of the ITAA 1997 have to be satisfied.

36. These requirements will be met as China Investments will not elect to claim indexation under subsection 110-25(8) in calculating any capital gains that it makes from the disposal of its Investment Portfolio. Furthermore, the assets that are subject to a discount capital gain will be held for at least 12 months prior to disposal.

37. Paragraph 115-285(1)(d) denies a LIC a discount capital gain in certain circumstances where, if the LIC had been an individual, the gain would not have been a discount capital gain for the purposes of sections 115-40 and 115-45 of the ITAA 1997.

38. For the purposes of section 115-40, China Investments will have held investments in respect of which the LIC capital gain is made, for a period of not less than 12 months. Further, there was and there will be no agreement entered into by China Investments for the purpose of extending the period of ownership of a CGT asset. Thus section 115-40 does not prevent any part of the net capital gain as being treated as a LIC capital gain.

39. Section 115-45 does not apply to China Investments as it will not have more than a 10% equity either directly or indirectly in a company or trust, when its Investment Portfolio is disposed of to the HK Fund.

40. Paragraph 115-285(1)(e) requires that the LIC capital gain is included in the net capital gain of the company.

41. China Investments will meet these requirements as the proceeds China Investments will receive from the sale of its equities will exceed the cost base of those equities for a significant number of transactions. Therefore, China Investments will include a net capital gain in its assessable income.

42. Paragraph 115-285(1)(f) requires that the LIC capital gain is reflected in the taxable income of the company for the income year in which the company had the net capital gain.

43. China Investments will make a net capital gain that will be included in its taxable income for the income year in which the net capital gain was made.

44. Subsection 115-285(2) requires that a capital gain is not a LIC capital gain if the company became a LIC after 1 July 2001 and acquired the CGT asset concerned before the day it became a LIC.

45. This subsection does not apply to China Investments as it was a LIC before 1 July 2001.

Section 115-290 of the ITAA 1997 defines a LIC

46. Paragraph 115-290(1)(a) requires that a LIC be an Australian resident.

47. China Investments is a resident of Australia as defined in subsection 6(1) of the ITAA 1936.

48. Paragraph 115-290(1)(b) requires that the shares of a LIC must be listed for quotation on the official list of the Australian Stock Exchange or of a body corporate that is approved as a stock exchange under section 769 of the Corporations Act 2001.

49. China Investments shares are listed for quotation on the Australian Stock Exchange.

50. Paragraph 115-290(1)(c) requires that at least 90% of the market value of CGT assets of a LIC must consist of investments permitted by subsection 115-290(4). Under subsection 115-290(4), shares are a permitted investment of a LIC

51. Since China Investments became a LIC, the market value of its shares has continuously accounted for more than 90% of the market value of China Investments CGT assets.

52. Subsection 115-290(7) requires that, subject to subsections 115-290(5) and 115-290(6), a LIC cannot own directly or indirectly more than 10% of another company or trust.

53. China Investments has not owned (directly or indirectly) more than 10% of another company or trust.

Detailed contents list

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Commissioner of Taxation

17 April 2002

<i>Previous draft:</i>	– ITAA 1997 110-25(5)
Not previously released in draft form.	– ITAA 1997 110-25(6)
	– ITAA 1997 110-25(8)
	– ITAA 1997 Subdiv 115-D
<i>Related Rulings/Determinations:</i>	– ITAA 1997 115-20
CR 2001/1; TR 92/1; TR 97/16	– ITAA 1997 115-25
	– ITAA 1997 115-40
<i>Subject references:</i>	– ITAA 1997 115-45
– CGT capital gains	– ITAA 1997 115-280(1)
– CGT capital proceeds	– ITAA 1997 115-280(1)(a)
– CGT cost base	– ITAA 1997 115-280(1)(b)
– CGT discount	– ITAA 1997 115-280(1)(c)
– CGT event	– ITAA 1997 115-280(2)
– CGT exemptions	– ITAA 1997 115-280(3)
– CGT indexation	– ITAA 1997 115-285
– deduction for certain shareholders	– ITAA 1997 115-285(1)(a)
– LIC capital gain	– ITAA 1997 115-285(1)(c)
– listed investment company	– ITAA 1997 115-285(1)(d)
– permitted investments	– ITAA 1997 115-285(1)(e)
– 90% market value test	– ITAA 1997 115-285(1)(f)
	– ITAA 1997 115-285(2)
<i>Legislative references:</i>	– ITAA 1997 115-290
– ITAA 1997 6-5	– ITAA 1997 115-290(1)(a)
– ITAA 1997 104-10	– ITAA 1997 115-290(1)(b)
– ITAA 1997 104-10(4)	– ITAA 1997 115-290(1)(c)
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– ITAA 1997 110-25(3)	– ITAA 1997 115-290(7)
– ITAA 1997 110-25(4)	– ITAA 1997 116-20

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- ITAA 1997 116-20(1)
- ITAA 1997 118-20(1)
- ITAA 1997 995-1(1)
- ITAA 1936 6(1)
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- ITAA 1953 Pt IVAAA
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Case references:

- FC of T v Equitable Life and
General Insurance Co.Ltd 90 ATC
4438

ATO References

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