



CR 2004/116 - Income tax: FKP Limited: FKP Property Group stapling arrangement

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Class Ruling

Income tax: FKP Limited: FKP Property Group stapling arrangement

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Preamble

*The number, subject heading, **What this Class 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 laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - subsection 44(1) of the ITAA 1936;
 - section 45B of the ITAA 1936;
 - section 45C of the ITAA 1936;
 - Division 104 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-135 of the ITAA 1997;
 - section 109-10 of the ITAA 1997;
 - section 110-25 of the ITAA 1997; and
 - section 110-55 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies are those shareholders in FKP Limited (FKP) who:
- participate in the arrangement that is the subject of this Ruling;
 - hold their FKP shares on capital account; and
 - are residents of Australia within the meaning of that term in subsection 6(1) of the ITAA 1936.

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 actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 14.
6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:
- 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
 - this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies to the income year ending 30 June 2005. The arrangement will be carried out within that income year.

Withdrawal

9. This Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the arrangement during the term of the Ruling.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on and incorporates the following documents:

- Class Ruling request from KPMG dated 29 July 2004; and
- draft Explanatory Memorandum (dated 20 September 2004) relating to the proposal to staple shares in FKP to units in FKP Property Trust including:
 - Scheme of Arrangement between FKP and each FKP shareholder;
 - Notice of Court Ordered Share Scheme Meeting;
 - Notice of General Meeting of FKP;
 - Implementation Deed; and
 - FKP Property Group Stapling Deed.

11. FKP, an Australian listed public company, owns all of the units (initial units) in FKP Property Trust (FKP Trust), an unlisted registered managed investment scheme.

12. Under the arrangement, shares in FKP will be stapled to new units issued in FKP Trust, on a one for one basis, to form an FKP Property Group stapled security. FKP Property Group stapled securities will be traded on the ASX. The arrangement will be implemented by way of a scheme of arrangement between FKP and its shareholders and by the amendment of the constitutions of FKP and FKP Trust.

13. The proposed scheme of arrangement will involve the following steps.

- FKP will pay to its shareholders \$1.00 in respect of each share owned on the 'stapling strategy record date' (proposed to be 11 November 2004). The distribution will consist of a fully franked special dividend of \$0.25 and a capital distribution of \$0.75.
- On the 'implementation date' (proposed to be 12 November 2004), FKP on behalf of its shareholders will apply \$0.93 of the distribution as the subscription price for a unit in FKP Trust. The balance of the

distribution (\$0.07) will be paid directly to FKP shareholders.

- Each share in FKP will be stapled to a unit in FKP Trust.

14. The total amount of capital returned will be debited to the untainted share capital account of FKP.

Internalised management

15. Development work or property management work will only be carried out by or for FKP Property Trust or in relation to property held by FKP Property Trust primarily for the purpose of deriving rent on terms which will avoid any diversion of trading business income to FKP Property Trust and which will avoid conveying control over activities producing trading business income to FKP Property Trust.

16. Under current income tax legislation, FKP Property Trust is generally not liable for Australian income tax, including capital gains tax, provided FKP Property Trust distributes all of its taxable income. Should the actions or activities of FKP Property Trust cause the trust to fall within the operative provisions of Division 6C of Part III of the ITAA 1936, the trust may be taxed on its net income.

Ruling

Dividend

17. The \$0.25 fully franked special dividend component of the distribution to be paid under the arrangement is included in the assessable income of the shareholder under subsection 44(1) of the ITAA 1936.

Capital distribution

18. CGT event G1 in section 104-135 of the ITAA 1997 will happen when FKP pays to its shareholders the capital distribution of \$0.75 per share.

19. The cost base and reduced cost base of each share will be reduced by the amount of the capital distribution (subsections 104-135(3) and (4) of the ITAA 1997). An FKP shareholder will make a capital gain from CGT event G1 happening to each FKP share to the extent that the distribution exceeds the share's cost base (subsection 104-135(3) of the ITAA 1997).

20. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the return of capital to shareholders.

Issue of new units

21. The first element of the cost base and reduced cost base of each FKP Trust unit acquired under the arrangement will be \$0.93 (sections 110-25 and 110-55 of the ITAA 1997).

22. Each FKP Trust unit will be acquired when it is issued to FKP shareholders (section 109-10 of the ITAA 1997).

Stapling of securities

23. No CGT event in Division 104 of the ITAA 1997 will happen as a result of the stapling of each FKP Trust unit to an FKP share.

Explanation

Dividend

24. Subsection 44(1) of the ITAA 1936 includes in a resident shareholder's assessable income a dividend, as defined by subsection 6(1) of the ITAA 1936, paid to the shareholder out of company profits.

25. Subject to certain exceptions, the definition of dividend in subsection 6(1) of the ITAA 1936 includes any distribution made by a company to any of its shareholders, whether in money or other property.

26. The \$0.25 fully franked special dividend component of the distribution to be paid to FKP shareholders under the arrangement will be assessable as a dividend under subsection 44(1) of the ITAA 1936.

27. Generally, an amount equal to the amount of the franking credit is included in the assessable income of a shareholder that is a company or individual under subsection 207-20(1) of the ITAA 1997 and they are also entitled to a tax offset under subsection 207-20(2) of the ITAA 1997.

28. However, there are provisions which may deny a franking credit in certain circumstances. For instance, paragraph 207-145(1)(a) of the ITAA 1997 requires that a shareholder receiving a franked distribution be a 'qualified person' for the purposes of Division 1A of Part IIIA of the ITAA 1936 in order to obtain a franking credit or tax offset. Broadly speaking, to be a qualified person in relation to a dividend a taxpayer must satisfy the holding period rule.

29. The holding period rule requires shareholders to hold the shares or the interest in the shares on which the dividend is paid at risk for a continuous period of at least 45 days. In determining whether a shareholder has satisfied the holding period rule, any days during which there is a materially diminished risk in relation to the relevant shares are not counted. The day of acquisition and day of disposal of the relevant shares are also not counted.

Capital distribution

30. CGT event G1 happens if a company makes a payment to a taxpayer in respect of a share the taxpayer owns in the company where some or all of the payment is neither a dividend, nor an amount taken to be a dividend under section 47 of the ITAA 1936 (subsection 104-135(1) of the ITAA 1997).

31. If the amount of the capital distribution (\$0.75 per FKP share) is not more than the cost base of the FKP share at the time of the payment, the cost base and reduced cost base of the share are reduced by the amount of the capital distribution (subsection 104-135(4) of the ITAA 1997).

32. A FKP shareholder will make a capital gain if the capital distribution is more than the cost base of their share. The amount of the capital gain is equal to this excess. If a FKP shareholder makes a capital gain, the cost base and reduced cost base of the share is reduced to nil (subsection 104-135(3) of the ITAA 1997). A shareholder cannot make a capital loss from the receipt of the capital distribution.

Application of section 45B of the ITAA 1936

33. Section 45B of the ITAA 1936 applies where certain capital payments, including a return of capital, are paid to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
- under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, obtain a tax benefit (paragraph 45B(2)(b) of the ITAA 1936); and
- having regard to the relevant circumstances of the scheme, it would be considered that the person, or one of the persons, entered into the scheme or carried out the scheme, or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

34. In this case, while the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are satisfied, the requisite purpose of enabling the shareholders to obtain a tax benefit – by way of a capital distribution – is not present. The purpose of the capital distribution is to provide FKP with a more efficient structure to undertake property investment which will diversify core business activities, increase retained earnings and build on its integrated business model.

35. The relevant circumstances of this arrangement include:
- the proposed capital distribution cannot be said to be attributable to the realised or unrealised profits of FKP (paragraph 45B(8)(a) of the ITAA 1936);
 - the pattern of distributions is not affected by the capital return which indicates that it is not a payment in substitution for a dividend (paragraph 45B(8)(b));
 - most shareholders are Australian residents and all shares were acquired after 19 September 1985 (paragraphs 45B(8)(d) and 45B(8)(e));
 - the cost bases of the shares prior to the capital reduction are not substantially less than the value of the benefit provided by the capital return (paragraph 45B(8)(f));
 - the proportional interests held by the shareholders after the distribution of capital will be the same as that that would have been held had an equivalent dividend been paid instead of the capital benefit (paragraph 45B(8)(h)); and
 - the capital return will apply to all shareholders equally (paragraph 45B(8)(k)).

36. Having regard to the relevant circumstances outlined in paragraph 33, on balance it cannot be concluded that either FKP or the shareholders entered into or carried out the arrangement for the purpose, not being an incidental purpose, of enabling such shareholders to obtain a tax benefit.

37. Therefore, section 45B of the ITAA 1936 will not apply to the arrangement and the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the return of capital to shareholders. It is therefore considered that the capital distribution will not be assessable as a dividend under the ITAA 1936.

Issue of FKP Trust units

38. Sections 110-25 and 110-55 of the ITAA 1997 provide that the first element of the cost base and reduced cost base, respectively, of a CGT asset is the money paid in respect of its acquisition.

39. FKP shareholders will be taken to have paid \$0.93 for each FKP Trust unit (as a result of that amount being applied by FKP on their behalf).

40. Accordingly, the first element of the cost base and reduced cost base of each FKP Trust unit will be \$0.93.

41. If a trustee issues units in circumstances where no contract is entered into in respect of the acquisition, the units are taken to have been acquired at the time of issue (item 3 in table in section 109-10 of the ITAA 1997).

42. Accordingly, FKP shareholders will be taken to have acquired each FKP Trust unit on the implementation date, 12 November 2004.

Stapling of securities

43. The effect of the FKP Property Group Stapling Deed is to apply restrictions to the transferability of the individual securities that make up an FKP Property Group stapled security. Each individual security (that is, an FKP share and an FKP Trust unit) will retain its legal character without any change in ownership. There will be no variation to the rights or obligations attaching to, or to the ownership of, the individual securities that make up the FKP stapled security as a consequence of stapling.

44. Therefore, no CGT event in Division 104 of the ITAA 1997 will happen as a consequence of the stapling of FKP shares to FKP Trust units.

Detailed contents list

45. Below is a detailed contents list for this Class Ruling:

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Commissioner of Taxation

29 October 2004

<i>Previous draft:</i>	- ITAA 1936 45B(8)(b)
Not previously issued as a draft	- ITAA 1936 45B(8)(d)
	- ITAA 1936 45B(8)(e)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(8)(f)
CR 2001/1; TR 92/1; TR 97/16	- ITAA 1936 45B(8)(h)
	- ITAA 1936 45B(8)(k)
<i>Subject references:</i>	- ITAA 1936 45B(3)
- acquisition of unit trust units	- ITAA 1936 45C
- capital gains	- ITAA 1936 47
- capital gains tax	- ITAA 1936 Pt III Div 6C
- CGT events G1-G3 – shares	- ITAA 1936 Pt IIIA Div 1A
- cost base	- ITAA 1997 Div 104
- dividend income	- ITAA 1997 104-135
- reduced cost base	- ITAA 1997 104-135(1)
- shares	- ITAA 1997 104-135(3)
- stapled structure	- ITAA 1997 104-135(4)
	- ITAA 1997 109-10
<i>Legislative references:</i>	- ITAA 1997 110-25
- ITAA 1936 6(1)	- ITAA 1997 110-55
- ITAA 1936 44(1)	- ITAA 1997 207-20(1)
- ITAA 1936 45B	- ITAA 1997 207-20(2)
- ITAA 1936 45B(2)(a)	- ITAA 1997 207-145(1)(a)
- ITAA 1936 45B(2)(b)	- TAA 1953 Pt IVA
- ITAA 1936 45B(2)(c)	- Copyright Act 1968
- ITAA 1936 45B(8)(a)	

ATO references

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