



CR 2005/33 - Income tax: capital gains tax: variation of share rights: Singleton Equity Housing Limited

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Class Ruling

Income tax: capital gains tax: variation of share rights: Singleton Equity Housing Limited

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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**, **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:

- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-25 of the ITAA 1997;
- section 104-35 of the ITAA 1997;
- section 104-135 of the ITAA 1997;
- section 104-155 of the ITAA 1997;
- section 104-250 of the ITAA 1997; and
- Division 725 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is persons who hold shares in Singleton Equity Housing Limited (SEHL) at any time during the period that starts at the time the arrangement that is the subject of this Ruling commences and ends at the time immediately after the new SEHL constitution comes into force.

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 9 to 16.
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 - this Ruling may be withdrawn or modified.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 Class Ruling applies to the 2004-2005 and 2005-2006 income years.

Arrangement

9. The arrangement that is the subject of the Ruling is described below. The description is based on, and includes, the following documents:
 - Class Ruling application from Ernst & Young dated 26 October 2004;
 - Memorandum & Articles of Association of SEHL;
 - proposed new Constitution of SEHL;
 - pro-forma occupancy agreement between SEHL and member; and

- correspondence from Ernst & Young dated 2 March 2005 providing further information to the Australian Taxation Office.

10. The arrangement that is the subject of this Ruling involves the variation of rights attaching to the SEHL shares so that:

- ordinary shareholders and redeemable preference shareholders will no longer have an entitlement to receive the profit, income or assets of the company directly or indirectly; and
- redeemable preference shareholders will only be entitled to be repaid the amount of their capital contribution on the redemption of their share by SEHL or on winding up SEHL.

11. The arrangement will be implemented by way of SEHL adopting a new constitution.

12. SEHL is a public unlisted company incorporated in Australia that provides housing for people with intellectual disabilities. This is achieved through SEHL issuing to these people redeemable preference shares which carry a right to occupy a specified property owned by SEHL as a principal place of residence.

13. Currently, both ordinary shareholders and redeemable preference shareholders hold voting rights, and the right to participate in the distribution of the surplus assets of SEHL on winding up in proportion to the amount paid up on their shares.

14. SEHL can also currently distribute property and profits from the company to its shareholders and redeem shares for their market value.

15. SEHL obtains funding from sources that include share capital subscriptions received from holders of redeemable preference shares, or their nominees, and loan funds obtained from commercial lenders and government bodies.

16. No shares or other interests will be issued under the arrangement. SEHL have advised that there will be no increase in the market value of SEHL shares in, or loans to, it under the arrangement.

Ruling

17. The variation of rights attaching to the SEHL shares will not give rise to a direct value shift under section 725-145 of the ITAA 1997.

18. The variation of rights attaching to the SEHL shares will cause CGT event H2 in section 104-155 of the ITAA 1997 to happen in respect of those shares. However, no ordinary shareholder or redeemable preference shareholder will make a capital gain as a result of the event happening because they will not receive capital proceeds.

19. No other CGT event in Division 104 of the ITAA 1997 will happen as a result of the variation of rights attaching to the SEHL shares.

Explanation

Direct value shifting – application of Division 725

20. Division 725 of the ITAA 1997 may apply where there is a direct value shift under a scheme involving equity or loan interests in an entity. Where certain threshold conditions are satisfied for a direct value shift, CGT event K8 in section 104-250 of the ITAA 1997 can happen, and cost base and reduced cost base adjustments can be required: Subdivision 725-D of the ITAA 1997.

21. There is a direct value shift under a scheme involving equity or loan interests in an entity if, under that scheme, there is a decrease in the market value of some of the equity or loan interests in that entity, and an increase in the market value or an issue at a discount of other equity or loan interests: section 725-145 of the ITAA 1997.

22. There is no direct value shift under the arrangement that involves the variation of rights attaching to the SEHL shares. There will be a decrease in the market value of the SEHL shares, as ordinary shareholders and redeemable preference shareholders will no longer be entitled to participate in the distribution of the profit, income or assets of the company. However, there is no increase in the market value, or issue at a discount, of any equity or loan interest under the arrangement: subsections 725-145(2) and (3) of the ITAA 1997.

CGT events

23. The CGT events that may be relevant to the variation of rights attaching to the SEHL shares are CGT events A1, C2, D1 and H2.

24. Taxation Ruling TR 94/30 sets out the CGT consequences arising from a variation of share rights. Although that Ruling is expressed in terms of the *Income Tax Assessment Act 1936* (ITAA 1936), Taxation Ruling TR 97/16 provides that rulings about ITAA 1936 provisions continue to apply when the provisions are rewritten in the ITAA 1997 provided the new law expresses the same idea as the old law.

25. Each of the provisions referred to in TR 94/30 were relevantly rewritten to express the same idea.

CGT events A1 and C2

26. Paragraphs 8 and 9 of Taxation Ruling TR 94/30 provide that the variation of rights attaching to a share does not result in the full disposal of an asset for the purposes of Part IIIA of the ITAA 1936 unless there is a cancellation or redemption of the share. Nor does it result in a part disposal of an asset.

27. In the context of the rewritten provisions, it is considered that the proposed variations of rights would not result in CGT event A1 in section 104-10 of the ITAA 1997 (about disposal of a CGT asset) or CGT event C2 in section 104-25 of the ITAA 1997 (about cancellation, surrenders or similar endings) happening.

CGT event D1

28. Paragraph 10 of Taxation Ruling TR 94/30 provides that a variation of rights does not constitute a deemed disposal of shares under subsection 160M(6) of the ITAA 1936. Accordingly, the proposed variations of rights will not cause CGT event D1 in section 104-35 of the ITAA 1997 to happen.

CGT event H2

29. Paragraph 10 of Taxation Ruling TR 94/30 provides that a variation in rights for money or other consideration does give rise to a deemed disposal under subsection 160M(7) of the ITAA 1936 where the other requirements of the subsection are met. That subsection has been rewritten as CGT event H2.

30. CGT event H2 in section 104-155 of the ITAA 1997 happens if an act, transaction or event occurs in relation to a CGT asset and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base. The variation of rights attaching to the SEHL shares is an act, transaction or event in relation to those shares. Therefore, the variation results in CGT event H2 happening in relation to them.

31. A capital gain is made if the capital proceeds from the event are more than the incidental costs incurred in relation to it. A capital loss is made if the capital proceeds are less than the incidental costs: see subsection 104-155(3) of the ITAA 1997.

32. Subsection 116-20(2) of the ITAA 1997 provides that the capital proceeds from CGT event H2 happening are the money or other consideration received, or entitled to be received, because of the act, transaction or event. No shareholder in SEHL will receive or be entitled to receive money or other consideration in respect of the event happening.

33. Therefore, although CGT event H2 will happen in respect of the SEHL shares, the holders of those shares will not make a capital gain. They will make a capital loss to the extent of any incidental costs they incur in respect of the variation.

Detailed contents list

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Commissioner of Taxation

18 May 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 94/30;
TR 97/16

Subject references:

- CGT asset
- CGT event
- capital proceeds
- direct value shift
- shares

Legislative references:

- ITAA 1936 Pt IIIA
- ITAA 1936 160M(6)
- ITAA 1936 160M(7)
- ITAA 1997 Div 104
- ITAA 1997 104-10
- ITAA 1997 104-25
- ITAA 1997 104-35
- ITAA 1997 104-135
- ITAA 1997 104-155
- ITAA 1997 104-155(3)
- ITAA 1997 104-250
- ITAA 1997 116-20(2)
- ITAA 1997 Div 725
- ITAA 1997 725-145

- ITAA 1997 725-145(2)	- TAA 1953 Pt IVAAA
- ITAA 1997 725-145(3)	- Copyright Act 1968
- ITAA 1997 Subdiv 725-D	

ATO references

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Income tax ~~ Capital Gains Tax ~~ CGT events H1 and
H2 – special capital receipts