



CR 2005/81 - Income tax: exchange of shares in Sigma Company Limited for shares in Arrow Pharmaceuticals Limited

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Class Ruling

Income tax: exchange of shares in Sigma Company Limited for shares in Arrow Pharmaceuticals Limited

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax laws, 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:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Division 13A of Part III of the ITAA 1936;
 - section 139DQ of the ITAA 1936;
 - section 139DR of the ITAA 1936;
 - section 139E of the ITAA 1936;
 - Subdivision 124-M of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - subsection 130-83(1A) of the ITAA 1997; and
 - section 170-260 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is all shareholders of Sigma Company Limited (Sigma) who:
- (a) are 'residents of Australia' within the meaning of subsection 6(1) of the ITAA 1936;
 - (b) participate in the Scheme of Arrangement for Sigma shareholders under the proposed merger of Sigma and Arrow Pharmaceuticals Limited (Arrow);
 - (c) hold their Sigma shares on capital account; and
 - (d) are not 'significant stakeholders' or 'common stakeholders' within the meaning of those expressions in Subdivision 124-M of the ITAA 1997.

Persons belonging to this class of persons will be participating shareholders.

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 year ended 30 June 2006 or substituted accounting period. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Ruling (refer to paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Arrangement

9. The arrangement that is the subject of the Ruling is described below. This description is based on the documents listed below. 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) Class Ruling application dated 2 September 2005 from KPMG requesting the Tax Office make a Class Ruling in relation to the capital gains tax scrip for scrip roll-over provisions as they apply to the exchange of Sigma ordinary shares for Arrow ordinary shares;
- (b) the documentation accompanying the application:
 - Scheme of Arrangement;
 - Deed Poll;
 - Employee Share Scheme booklet; and
 - Employee share plan rules; and
- (c) correspondence from Sigma dated 23 September 2005 providing further information to the Tax Office.

10. On 22 August 2005, Sigma announced to the Australian Stock Exchange (ASX) a proposed merger with Arrow pursuant to a scheme of arrangement.

11. When the proposed merger happens all of the Sigma ordinary shares on issue will be transferred to Arrow with effect from the merger implementation date such that Sigma will become a 100% subsidiary of Arrow.

12. In consideration for the transfer of Sigma ordinary shares to Arrow, Arrow will issue to Sigma shareholders resident in Australia 4.435 ordinary Arrow shares for each Sigma ordinary share held. Any fractional entitlement will be rounded up.

13. The Arrow shares that would otherwise have been issued to certain Sigma shareholders who are residents of a country where the issue of shares under the scheme is not authorised, will instead be transferred to such other persons nominated by Arrow, or the merged entity. Those shares will then be sold on the ASX with the net sale proceeds being remitted to the relevant foreign shareholders.

14. Participating shareholders include Sigma employees who have acquired Sigma ordinary shares under Sigma's Employee Share Scheme (ESS).

15. The applicant has advised that:

- all shares acquired under the Sigma ESS are qualifying shares for the purposes of Division 13A of Part III (Division 13A) of the ITAA 1936;
- Arrow shares issued to participating shareholders who acquired their shares under the Sigma ESS will be matching shares for the purposes of Division 13A;
- after the merger no participating shareholder who acquired shares under the Sigma ESS will hold a legal or beneficial interest in more than 5% of Arrow shares; and
- after the merger no participating shareholder who acquired shares under the Sigma ESS will be in a position to cast, or control the casting of, more than 5% of the maximum number of votes that may be cast at a general meeting of the new company.

16. Both Sigma and Arrow are listed on the ASX and are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936.

Ruling

[All legislative references are to the ITAA 1997 unless stated otherwise.]

17. Where a participating shareholder who acquired their shares under the Sigma ESS disposes of a Sigma share under the proposed merger, any capital gain or capital loss the participating shareholder makes in relation to the disposal is disregarded, pursuant to subsection 130-83(1A), provided the participating shareholder:

- has not made an election under section 139E of the ITAA 1936 in respect of the share;
- has not had a cessation time (within the meaning of Division 13A) happen to the share before the proposed merger; and
- is employed by a company in the Arrow group after the proposed merger.

18. In all other cases the participating shareholder can choose roll-over under Subdivision 124-M in relation to a Sigma ordinary share if:

- (a) they acquired the ordinary share on or after 20 September 1985;
- (b) apart from the roll-over that Subdivision 124-M provides, they would make a capital gain in relation to the disposal of their Sigma ordinary share; and
- (c) any capital gain that could be made upon a future CGT event happening in relation to the replacement ordinary shares in Arrow would not be disregarded (except because of a roll-over).

19. Where the participating shareholder chooses roll-over in respect of a Sigma ordinary share, the capital gain arising from the exchange of that share is disregarded.

Explanation

Availability of scrip for scrip roll-over

20. Scrip for scrip roll-over in Subdivision 124-M enables a shareholder to disregard a capital gain they make from a share that is disposed of as part of a corporate takeover or merger if the shareholder receives in exchange replacement shares.

21. The capital gain is disregarded completely if the only capital proceeds the shareholder receives is the replacement shares.

22. The first element of the cost base of each Arrow ordinary share received under the arrangement will be equal to an amount which is reasonably attributable to the cost base of the Sigma ordinary share for which it was exchanged and for which roll-over was obtained (subsection 124-785(2)). The first element of the reduced cost base of each Arrow ordinary share is worked out on a similar basis (subsection 124-785(4)).

23. Subdivision 124-M contains a number of conditions for, and exceptions to, the eligibility of a shareholder to choose scrip for scrip roll-over. Below is an outline of the main conditions and exceptions which are relevant to the circumstances of the arrangement that is the subject of this Ruling.

Subparagraph 124-780(1)(a)(i) requires an entity to exchange a share in a company for a share in another company

24. This requirement will be satisfied by a Sigma shareholder as under the Scheme of Arrangement, a Sigma ordinary share is exchanged for Arrow ordinary shares.

Paragraph 124-780(1)(b) requires that the exchange of shares is in consequence of a single arrangement

25. In the context of the scrip for scrip provisions, the exchange of ordinary shares under the Scheme of Arrangement is considered to be in consequence of a single arrangement.

Paragraph 124-780(2)(a) requires that the exchange of shares is in consequence of a single arrangement that results in the acquiring entity (Arrow) becoming the owner of 80% or more of the voting shares in the original entity (Sigma)

26. Under the Scheme of Arrangement Arrow becomes the owner of 100% of the voting shares and therefore this requirement is satisfied.

Paragraphs 124-780(1)(b) and 124-780(2)(b) require that the exchange of shares be in consequence of a single arrangement in which at least all owners of voting shares in the original entity (Sigma) (apart from the acquiring entity (Arrow) or members of the acquiring entity's wholly-owned group) could participate

27. All owners of voting shares in Sigma are able to participate in the Scheme of Arrangement and therefore this requirement is satisfied.

Paragraphs 124-780(1)(b) and 124-780(2)(c) require that the exchange of shares is in consequence of a single arrangement in which participation was available on substantially the same terms for all of the owners of interests of a particular type in the original entity (Sigma)

28. This requirement is satisfied as all the ordinary shareholders in Sigma who are able to participate under the Scheme of Arrangement are offered ordinary shares in Arrow.

29. Issuing to a nominee for sale, the Arrow ordinary shares to which some foreign shareholders of Sigma would otherwise be entitled, does not prevent the arrangement being on substantially the same terms for all owners of ordinary shares in Sigma.

Paragraphs 124-780(1)(c) and 124-780(3)(a) require the original interest holder (a Sigma ordinary shareholder) to have acquired its original interest (a Sigma ordinary share) on or after 20 September 1985

30. Roll-over will only be available for those Sigma ordinary shares that were acquired on or after 20 September 1985. Paragraph 18(a) limits this Ruling in this regard.

Paragraphs 124-780(1)(c) and 124-780(3)(b) require that, apart from the roll-over, the original interest holder (a Sigma ordinary shareholder) would make a capital gain from a CGT event happening in relation to the original interest (a Sigma ordinary share)

31. Whether a Sigma ordinary shareholder would, apart from the roll-over, make a capital gain from the disposal of a share to Arrow, is a question of fact that is dependent on the specific circumstances of each shareholder – in particular on the cost base of each Sigma ordinary share and the value of the capital proceeds received. Paragraph 18(b) limits this Ruling in this regard.

Paragraphs 124-780(1)(c) and 124-780(3)(c) require that the replacement interest is in the acquiring entity (Arrow)

32. This requirement is satisfied as the replacement ordinary shares will be in Arrow which is the ultimate holding company of a wholly-owned group.

Paragraphs 124-780(1)(c) and 124-780(3)(d) require that the original interest holder (a Sigma ordinary shareholder) choose to obtain the roll-over

33. Whether a Sigma ordinary shareholder chooses roll-over is a question of fact.

Additional requirements in subsection 124-780(5) must be satisfied if the original interest holder (a Sigma ordinary shareholder or option holder) and the acquiring entity (Arrow) did not deal with each other at arm's length and:

- (a) neither the original entity (Sigma) nor the replacement entity (Arrow) had at least 300 members just before the arrangement started: paragraph 124-780(4)(a); or***
- (b) the original interest holder (a Sigma ordinary shareholder or option holder), the original entity (Sigma) and the acquiring entity (Arrow) were all members of the same linked group just before the arrangement started: paragraph 124-780(4)(b)***

34. If Sigma and Arrow are dealing with each other at arms length, then paragraphs 124-780(4)(a) and 124-780(4)(b) do not apply.

35. Even if Sigma and Arrow were not dealing with each other at arms length, paragraph 124-780(4)(a) will not apply because Sigma has at least 300 members just before the arrangement started. Section 124-810 will not apply to Sigma as its ownership is not concentrated in the manner contemplated by that section.

36. Paragraph 124-780(4)(b) will also not apply because even if Sigma and Arrow were members of the same linked group (within the meaning of section 170-260) just before the arrangement started, no Sigma ordinary shareholder would have been a member of that group.

Exceptions to obtaining scrip for scrip roll-over

Paragraph 124-795(2)(a) provides that the roll-over is not available if any capital gain the original interest holder (a Sigma ordinary shareholder) might make from their replacement interest (Arrow ordinary shares) would be disregarded

37. This exception may apply if, for example, the Arrow ordinary shares are held as trading stock. Paragraph 18(c) limits this Ruling in this regard.

Paragraph 124-795(2)(b) provides that the roll-over is not available if the original interest holder (a Sigma ordinary shareholder) and the acquiring entity (Arrow) are members of the same wholly-owned group just before the original interest holder stops owning their original interest (a Sigma ordinary share), and the acquiring entity is a foreign resident

38. This exception does not apply as Arrow is not a foreign resident.

Where a participating shareholder who acquired their shares under the Sigma ESS disposes of a Sigma share under the proposed takeover, any capital gain or capital loss the participating shareholder makes in relation to the disposal is disregarded, pursuant to subsection 130-83(1A)

39. Where an employee acquires a qualifying share under an employee share scheme and the employee does not make an election under section 139E of the ITAA 1936 in respect of the share, any capital gain or capital loss they make on the transfer or disposal of that share will be disregarded where the share is transferred or disposed of in connection with the acquisition of another share which pursuant to section 139DQ of the ITAA 1936 is treated for the purposes of Division 13A as if it were a continuation of the original share, pursuant to subsection 130-83(1A).

40. The applicant has advised that Arrow shares issued to participating shareholders who acquired their original shares under the Sigma ESS will be matching shares for the purposes of Division 13A.

41. Section 139DQ of the ITAA 1936 sets out in the first instance the circumstances whereby the acquisition of shares under a 100% takeover will be treated as a continuation of original shares. Further, section 139DR of the ITAA 1936 sets out the conditions that need to be met for matching shares to be treated as if they are a continuation of the original shares.

42. In accordance with the information provided by the applicant the Commissioner accepts that the circumstances described in section 139DQ of the ITAA 1936 will be present and the conditions set out in section 139DR of the ITAA 1936 will be met such that Arrow shares acquired under the proposed merger will be treated as if they were a continuation of Sigma shares acquired under the Sigma ESS.

43. Thus, where a participating shareholder who acquired shares under the Sigma ESS makes a capital gain or capital loss on the transfer or disposal of their shares under the proposed merger, it will be disregarded where:

- they have not made an election under section 139E of the ITAA 1936 in respect of the shares;
- a cessation time (within the meaning of Division 13A) has not already happened in relation to the shares; and
- they are employed by a company in the Arrow group after the proposed merger.

Detailed contents list

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- (a) neither the original entity (Sigma) nor the replacement entity (Arrow) had at least 300 members just before the arrangement started: paragraph 124-780(4)(a); or*
- (b) the original interest holder (a Sigma ordinary shareholder or option holder), the original entity (Sigma) and the acquiring entity (Arrow) were all members of the same linked group just before the arrangement started: paragraph 124-780(4)(b)* 34

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Commissioner of Taxation

12 October 2005

Previous draft:

Not previously issued as a draft

*Related Rulings/Determinations:*CR 2001/1; TR 92/1; TR 92/20;
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Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 Pt III Div 13A
- ITAA 1936 139DQ
- ITAA 1936 139DR
- ITAA 1936 139E
- ITAA 1997 Subdiv 124-M
- ITAA 1997 124-780(1)(a)(i)
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- ITAA 1997 124-795(2)(a)
- ITAA 1997 124-795(2)(b)
- ITAA 1997 124-810
- ITAA 1997 130-83(1A)
- ITAA 1997 170-260
- Copyright Act 1968
- TAA 1953 Pt IVAAA

ATO references

NO: 2005/14361

ISSN: 1445-2014

ATOlaw topic: Income Tax ~ Capital Gains Tax ~ roll-overs - scrip for scrip