

# ***CR 2007/67 - Income tax: scrip for scrip: acquisition of Smorgon Steel Group Limited by OneSteel Limited***

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## Class Ruling

### Income tax: scrip for scrip: acquisition of Smorgon Steel Group Limited by OneSteel Limited

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#### **① This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

#### **Relevant provision(s)**

2. The relevant provisions dealt with in this Ruling are:

- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Subdivision 115-A of the ITAA 1997;
- section 116-20 of the ITAA 1997; and
- Subdivision 124-M of the ITAA 1997.

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

## Class of entities

3. The class of entities to which this Ruling applies are the shareholders of Smorgon Steel Group Limited (Smorgon) who:
- (a) are residents of Australia within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) at the time the scheme was undertaken;
  - (b) participate in the scheme under the proposed scheme of arrangement;
  - (c) hold their Smorgon shares on capital account;
  - (d) dispose of their Smorgon shares to OneSteel Limited (OneSteel) in exchange for OneSteel ordinary shares and cash (if any); and
  - (e) are not 'significant stakeholders' or 'common stakeholders' within the meaning of those expressions in Subdivision 124-M.

## Qualifications

4. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 12 to 18 of this Ruling.
5. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
  - this Ruling may be withdrawn or modified.
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## Date of effect

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7. This Ruling applies from 18 July 2007 to 30 June 2008. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

8. 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 issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

9. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

10. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

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## Scheme

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12. The following description of the scheme is based on information provided by the applicant, Smorgon Steel Group Limited. The following documents, or relevant parts of them form part of and are to be read with the description.

- Class Ruling application dated 18 April 2007 from Clayton Utz;
- Merger Implementation Agreement dated 5 April 2007;
- Share Sale and Framework Deed dated 5 April 2007;
- Share Sale Agreement dated 5 April 2007; and
- Scheme Booklet dated 22 June 2007.

**Note:** certain information from Clayton Utz has been provided on a commercial in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

13. OneSteel and Smorgon are public companies listed on the Australian Stock Exchange (ASX). Both companies are residents of Australia as defined in subsection 6(1) of the ITAA 1936 and have more than 300 members.

14. On 26 June 2006, OneSteel announced to the ASX a proposal to merge with Smorgon. On 5 April 2007, Smorgon and OneSteel announced that they had signed a Merger Implementation Agreement (MIA) under which OneSteel proposes to acquire Smorgon by way of a court approved scheme of arrangement under Part 5.1 of the *Corporations Act 2001* (the Scheme). Following the Scheme, OneSteel will acquire 100% of Smorgon ordinary shares (Smorgon shares) from Smorgon shareholders on the Implementation Date, as defined in the MIA.

15. The consideration paid to Smorgon shareholders pursuant to the Scheme will be:

- (a) share consideration, being 0.4091 OneSteel shares for each Smorgon share held. This represents 9 OneSteel shares for every 22 Smorgon shares held; and
- (b) in certain circumstances, cash consideration, being an amount of cash calculated as follows and which will vary depending on the ASX Volume Weighted Average Price (VWAP) of OneSteel's shares (the OneSteel VWAP). If the OneSteel VWAP is between \$3.75 and \$4.15 (inclusive) then the cash consideration will be calculated as follows:

\$1.76 - Share Consideration Value - Smorgon Steel Special Dividend Value

where:

Share Consideration Value = 0.4091 × OneSteel Pricing VWAP; and

Smorgon Steel Special Dividend Value = 6.23 cents for each Smorgon share.

The cash consideration for each Smorgon share will therefore vary between nil, if the OneSteel VWAP is \$4.15 or greater and 16.36 cents, if the OneSteel VWAP is \$3.75 or less. The closing price of OneSteel shares on 6 July 2007 was \$6.63.

16. The effect of the formula is that, if the VWAP of OneSteel shares is below \$4.15 (but above \$3.75) over the ten business days immediately following the Scheme becoming effective, Smorgon shareholders will also be entitled to an additional cash component so that the economic value of the transaction to Smorgon shareholders is \$1.76 per Smorgon share.

17. The directors of Smorgon have declared a Smorgon Steel Special Dividend (the Dividend). The record date for the Dividend is 30 July 2007, the business day before the Scheme meeting.

18. The Dividend will be paid to persons who are Smorgon shareholders on the relevant record date irrespective of whether or not:

- (a) a Smorgon shareholder votes, or is entitled to vote, in favour of the Scheme;
- (b) a Smorgon shareholder is or becomes a Scheme shareholder; and
- (c) the Scheme becomes effective and is implemented.

## **Ruling**

### **Disposal of Smorgon shares**

19. CGT event A1 will happen when a Smorgon shareholder disposes of a Smorgon share on the Implementation Date (subsections 104-10(1) and 104-10(2) and paragraph 104-10(3)(b)).

20. A Smorgon shareholder will make a capital gain from CGT event A1 happening if the capital proceeds from the disposal of a Smorgon share exceeds its cost base. A Smorgon shareholder will make a capital loss if those capital proceeds are less than the Smorgon share's reduced cost base (subsection 104-10(4)).

21. The capital proceeds for each Smorgon share will be any cash consideration (if applicable) plus the market value of the share consideration (subsection 116-20(1)).

22. A Smorgon shareholder who makes a capital gain will be eligible to treat the gain as a discount capital gain providing they held the Smorgon share for at least 12 months before the disposal and the other requirements of Subdivision 115-A are satisfied (section 115-25).

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

23. A Smorgon shareholder is eligible to choose scrip for scrip roll-over under section 124-780 if:

- apart from the roll-over under Subdivision 124-M, they will make a capital gain when CGT event A1 happens to their Smorgon shares (paragraph 124-780(3)(b));
- they cannot disregard (except because of a roll-over) any capital gain they might make from a replacement OneSteel share (paragraph 124-795(2)(a)); and
- all other relevant requirements are satisfied. The requirements for the roll-over are explained in paragraphs 38 to 71 of this Ruling.

24. If a Smorgon shareholder chooses roll-over, a capital gain from a Smorgon share is disregarded to the extent that the shareholder received any OneSteel share. The capital gain is not disregarded to the extent that ineligible proceeds (cash consideration) are received for the disposal of the Smorgon shares (section 124-790).

### **Cost base of OneSteel shares**

25. If a Smorgon shareholder chooses roll-over, the first element of the cost base of a replacement OneSteel share is worked out by reasonably attributing to it the cost base of any Smorgon share for which it was exchanged (subsection 124-785(2)). However, the cost base of the Smorgon share must first be reduced by so much of it that is taken into account in working out the shareholder's capital gain relating to the cash consideration (subsections 124-785(2) and (3)). In working out that amount of the cost base of the Smorgon share that is reasonably attributable to the cash consideration, the Commissioner accepts the following method.

$$\text{Cost Base of Smorgon shares} \times \frac{\text{Value of cash consideration}}{\text{Value of share consideration} + \text{cash consideration}}$$

where:

- 1) share consideration means 9/22 (0.4091) OneSteel shares for each Smorgon share held as provided in subparagraph 15(a) of this Ruling; and
- 2) in the unlikely circumstance of an event crystallising the payment of cash consideration, the Commissioner accepts that the capital proceeds Smorgon shareholders receive for the disposal of a Smorgon share is the market value of the share consideration on the Implementation Date plus any amount of cash consideration. The market value of a OneSteel share may be determined by reference to the ASX VWAP of these shares on the Implementation Date. Refer to paragraph 34 of this Ruling under 'Capital proceeds'.

### **Acquisition date of OneSteel shares**

26. The acquisition date of OneSteel shares is the date that they were issued to each Smorgon shareholder (that is the Implementation Date) (section 109-10).

27. For Smorgon shareholders who choose scrip for scrip roll-over, the acquisition date of their OneSteel shares for CGT discount purposes is the date they acquired the corresponding Smorgon shares that were disposed of for the relevant OneSteel shares (item 2 of the table in subsection 115-30(1)).

## Appendix 1 – Explanation

**❶** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### Disposal of Smorgon shares to OneSteel

28. CGT event A1 happens if there is a change in the ownership of a CGT asset from one entity to another. The event happens when a contract to dispose of the asset is entered into, or if there is no contract, when the change of ownership occurs.

29. A Smorgon shareholder will make a capital gain from CGT event A1 happening if the capital proceeds from the disposal of a Smorgon share exceeds its cost base. A Smorgon shareholder will make a capital loss if those capital proceeds are less than the Smorgon share's reduced cost base.

30. The time when CGT event A1 happens determines the income year in which any capital gain or capital loss is made and whether the CGT discount applies to any capital gain.

31. A takeover or merger effected by a court approved scheme of arrangement does not involve a disposal of shares under a contract. Therefore, if a Smorgon shareholder disposes of a Smorgon share to OneSteel under the Scheme, CGT event A1 will happen when the change of ownership occurs, which is when their Smorgon shares are transferred to OneSteel on the Implementation Date.

### Capital proceeds

32. Section 116-20 provides that capital proceeds from a CGT event are the money and the market value of any property received or are entitled to be received (worked out at the time of the event happening).

33. The capital proceeds for Smorgon shareholders will be any cash consideration and share consideration received in respect of the transfer of the shares. The Dividend, the declaration and payment of which is not contingent upon the MIA going ahead, will not form part of the capital proceeds.

34. The capital proceeds Smorgon shareholders receive for the disposal of a Smorgon share is the market value of a OneSteel share on the Implementation Date plus any cash. The Commissioner accepts that the market value of a OneSteel share may be determined by reference to the ASX VWAP of OneSteel shares on the Implementation Date. OneSteel can provide this information to Smorgon shareholders to assist in determining this.



## **Discount capital gains**

35. A Smorgon shareholder who makes a capital gain from the disposal of the Smorgon shares, may be entitled to treat the gain as a discount capital gain in respect of those Smorgon shares that are held for at least 12 months provided the other requirements of Subdivision 115-A are satisfied (section 115-25).

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

36. Scrip for scrip roll-over enables a shareholder to disregard a capital gain they make from a share that is disposed of as part of a corporate restructure, including a merger, if the shareholder receives a replacement share in exchange.

37. The capital gain is disregarded completely if the only capital proceeds the shareholder receives are replacement shares. A capital gain will be only partially disregarded if, in addition to shares, there is cash consideration as part of the capital proceeds.

## **Requirements for scrip for scrip roll-over – Subdivision 124-M**

38. Subdivision 124-M contains a number of conditions for, and exceptions to, the eligibility of a shareholder to choose scrip for scrip roll-over. The main conditions and exceptions that are relevant to the Scheme that is the subject of this Ruling are:

- (a) shares are exchanged for shares in another company;
- (b) the exchange occurs as part of a single arrangement;
- (c) conditions for roll-over are satisfied;
- (d) further conditions are not applicable; and
- (e) exceptions to obtaining scrip for scrip roll-over are not applicable.

## ***Shares are exchanged for shares in another company***

39. Paragraph 124-780(1)(a) requires an entity (the original interest holder) to exchange a share for a share in another company.

40. This requirement is satisfied by a Smorgon shareholder who will receive OneSteel shares as part of the capital proceeds for the disposal of their Smorgon shares under the Scheme.

## ***The exchange occurs as part of a single arrangement***

41. Paragraph 124-780(1)(b) requires that shares in an entity be exchanged in consequence of a single arrangement.

42. In the context of the scrip for scrip roll-over, the merger of OneSteel and Smorgon under the Scheme is considered to be a single arrangement. The single arrangement must also satisfy the following conditions.

*(a) 80% ownership*

43. Paragraph 124-780(2)(a) requires that shares in an entity be exchanged in a single arrangement that results in another entity becoming the owner of 80% or more of the voting shares in the original entity.

44. This requirement will be satisfied as OneSteel (the acquiring entity) will become the owner of all the ordinary shares in Smorgon (the original entity) following the Scheme. Each of the ordinary shares satisfies the definition of a 'voting share' in subsection 995-1(1).

*(b) All voting share owners participate*

45. Paragraph 124-780(2)(b) requires that the exchange of shares is in consequence of a single arrangement in which at least all owners of voting shares in the original entity (apart from the acquiring entity or members of the acquiring entity's wholly-owned group) could participate.

46. This requirement will be satisfied because all Smorgon shareholders will be entitled to participate in the Scheme (other than OneSteel), if approved by the Smorgon shareholders.

*(c) Participation is on substantially the same terms*

47. Paragraph 124-780(2)(c) requires that the exchange 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.

48. This requirement will be satisfied because the Scheme provides that all the Smorgon shareholders will be entitled to participate in the Scheme on the same terms.

49. The issue of OneSteel shares to a nominee on behalf of ineligible foreign Smorgon shareholders does not prevent the arrangement from being on substantially the same terms for all owners of Smorgon shares.

***Conditions for roll-over are satisfied***

50. Paragraph 124-780(1)(c) requires that the conditions for roll-over outlined in subsection 124-780(3) are met. These conditions must be met in relation to each Smorgon share for which scrip for scrip roll-over will be chosen.

51. The conditions in subsection 124-780(3) are as follows.

*(a) The Smorgon shares are post-CGT shares*

52. Paragraph 124-780(3)(a) requires that the original interest holder acquired their original interests on or after 20 September 1985.

53. This requirement will be satisfied as all of the Smorgon shares have been acquired after 20 September 1985 due to the fact that Smorgon was incorporated in 1998.

*(b) A Smorgon shareholder would otherwise make a capital gain*

54. Paragraph 124-780(3)(b) requires that, apart from the rollover, the original interest holder would make a capital gain from a CGT event happening in relation to its original interest.

55. As explained in paragraph 20 of this Ruling, a capital gain will be made from the disposal of a Smorgon share if the capital proceeds for the share are more than its cost base. Therefore, whether this condition is met will depend on the individual circumstances of the Smorgon shareholder.

*(c) Smorgon shareholders receive replacement interests in the acquiring entity or the ultimate holding company*

56. Paragraph 124-780(3)(c) requires that the replacement interest is in the acquiring entity or the ultimate holding company of the wholly owned group which includes the acquiring entity.

57. This requirement will be satisfied as the Smorgon shareholders will receive shares in OneSteel.

*(d) A Smorgon shareholder must choose to obtain scrip for scrip roll-over*

58. Paragraph 124-780(3)(d) requires that the original interest holder chooses the roll-over, or if section 124-782 applies, the original interest holder and the replacement entity jointly choose to obtain the roll-over.

59. Section 124-782 has no application in the Scheme since there are no significant stakeholders or common stakeholders under the arrangement.

60. Subject to their eligibility (see paragraph 23 of this Ruling), whether a Smorgon shareholder chooses to obtain roll-over in relation to the disposal of a Smorgon share is a question of fact to be determined for each individual shareholder.

***Further conditions are not applicable***

61. Subsection 124-780(4) provides that the additional requirements in subsection 124-780(5) must be satisfied if the original interest holder and the acquiring entity did not deal with each other at arm's length and:

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

62. Paragraph 124-780(4)(a) will not apply because both Smorgon and OneSteel will have at least 300 members just before the arrangement started. Paragraph 124-780(4)(b) will not apply as Smorgon shareholders, Smorgon and OneSteel will not be members of the same linked group just before the arrangement commences.

***Exceptions to obtaining scrip for scrip roll-over are not applicable***

63. Section 124-795 contains a number of exceptions where scrip for scrip rollover cannot be chosen. The exceptions in section 124-795 are as follows.

***(a) Smorgon shareholders are residents of Australia***

64. Subsection 124-795(1) provides that roll-over is not available if, just before the disposal, the original interest holder is a foreign resident unless, just after the acquisition of the replacement interest, the replacement interest is not taxable Australian property.

65. The class of entities to whom this Ruling applies is limited to Smorgon shareholders who are residents of Australia at the time of the scheme. As a consequence, the exception in subsection 124-795(1) will not apply to limit this Ruling in that regard.

***(b) A capital gain cannot (apart from the roll-over) be otherwise disregarded***

66. Paragraph 124-795(2)(a) provides that the roll-over is not available if any capital gain the original interest holder might make from their replacement interest would be disregarded (except because of a roll-over).

67. Whether a capital gain arising from the disposal of a Smorgon share will be disregarded under another provision of the ITAA 1997 (for example, the Smorgon shares are trading stock held by the Smorgon shareholder) is a question of fact for each shareholder. Paragraph 3 and 23 limits the application of this Ruling in this regard.

*(c) Acquiring entity is not a foreign resident*

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

69. This exception will not apply as the Smorgon shareholders and OneSteel will not be members of the same wholly-owned group just before the proposed Scheme is implemented. In addition, OneSteel is not a foreign resident company.

*(d) No roll-over is available under Division 122 or Subdivision 124-G*

70. Subsection 124-795(3) provides that the roll-over is not available if a roll-over can be chosen under Division 122 or Subdivision 124-G.

71. This exception will not apply as the circumstances of the Scheme are such that a roll-over pursuant to Division 122 or Subdivision 124-G is not available.

***Consequences of roll-over***

72. Scrip for scrip roll-over enables a shareholder to disregard all or part of a capital gain from a share that is disposed of as part of a corporate take over or merger if the shareholder receives a replacement share in exchange.

73. If the only capital proceeds a Smorgon shareholder receives are replacement shares in OneSteel, and they are eligible for and chose the roll-over, the capital gain is disregarded completely (subsection 124-785(1)). All of the cost base of the Smorgon shares can be allocated to the replacement OneSteel shares (subsection 124-785(2)).

***Consequences of roll-over where OneSteel shares and cash are received as capital proceeds***

74. If the capital proceeds paid to Smorgon shareholders in respect of their Smorgon shares consist of cash consideration as well as OneSteel shares, a shareholder will be able to choose only partial roll-over. Roll-over will not be available to the extent that any capital gain is attributable to the cash consideration paid per Smorgon share (subsection 124-790(1)).

75. Only a portion of the cost base of the Smorgon shares can be allocated to the replacement OneSteel shares (subsections 124-785(2) and 124-785(3)).

76. In calculating the capital gain attributable to their cash consideration, a Smorgon shareholder must work out the proportion of the cash consideration received for their Smorgon shares in relation to the total capital proceeds. That proportion would be applied to the cost base of each Smorgon share to determine the part of that cost base which is reasonably attributable to the cash consideration (subsection 124-790(2)).

77. In working out that amount of the cost base of the Smorgon share that is reasonably attributable to the cash consideration, the Commissioner accepts the following method:

$$\text{Cost Base of Smorgon shares} \times \frac{\text{Value of cash consideration}}{\text{Value of share consideration} + \text{cash consideration}}$$

where:

- 1) share consideration means 9/22 (0.4091) OneSteel shares for each Smorgon share held as provided in subparagraph 15(a) of this Ruling; and
- 2) in the unlikely circumstance of an event crystallising the payment of cash consideration, the Commissioner accepts that the capital proceeds Smorgon shareholders receive for the disposal of a Smorgon share is the market value of the share consideration on the Implementation Date plus any amount of cash consideration. The market value of a OneSteel share may be determined by reference to the ASX VWAP of these shares on the Implementation Date. Refer to paragraph 34 of this Ruling under 'Capital Proceeds'.

78. When that proportion is worked out, the remaining proportion is used to determine the first element of the cost base (and reduced cost base) for replacement OneSteel shares issued as share consideration to a Smorgon shareholder (subsections 124-785(2), 124-785(3) and 124-785(4)).

### **Acquisition date of OneSteel shares**

79. The acquisition date of OneSteel shares is the date that they were issued to each Smorgon shareholder (that is the Implementation Date).

80. For Smorgon shareholders who choose scrip for scrip roll-over, the acquisition date of their OneSteel shares for CGT discount purposes is the date they acquired the corresponding Smorgon shares that were disposed of for the relevant OneSteel shares.

## Appendix 2 – Detailed contents list

81. The following is a detailed contents list for this Ruling:

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## References

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### *Previous draft:*

Not previously issued as a draft

### *Subject references:*

- arrangement
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- CGT event
- company
- cost base
- interests
- mergers
- ordinary share
- original interest
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- resident
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- ITAA 1997 124-780
- ITAA 1997 124-780(1)(a)
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- ITAA 1997 124-795(3)
- ITAA 1997 995-1(1)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
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- Corporations Act 2001 Pt 5.1

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- ITAA 1997 104-10(2)
- ITAA 1997 104-10(3)(b)
- ITAA 1997 104-10(4)
- ITAA 1997 109-10
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25
- ITAA 1997 115-30(1)
- ITAA 1997 116-20
- ITAA 1997 116-20(1)
- ITAA 1997 Div 122
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### ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT event A1 -  
disposal of a CGT asset  
Income Tax ~~ Capital Gains Tax ~~ discount capital  
gains  
Income Tax ~~ Capital Gains Tax ~~ roll-overs - scrip for  
scrip