CR 2007/98 - Income tax: Villa World Limited merger with MFS Diversified Limited

Class Ruling

Income tax: Villa World Limited merger with MFS Diversified Limited

Contents Para

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 provisions 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);
- subsection 110-25(2) of the ITAA 1997;
- subsection 110-55(2) of the ITAA 1997;
- subsection 112-30(1) of the ITAA 1997;
- section 116-20 of the ITAA 1997; and
- section 118-20 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is Australian residents who were ordinary shareholders of Villa World Limited (VWL Shareholders), who were listed on the share register of Villa World Limited (VWL) as at 1 August 2006, held their ordinary shares in VWL on capital account, and acquired ordinary shares in MFS Diversified Limited (MFS Diversified) stapled to units in MFS Diversified Trust (MFS Trust) as a result of the merger between VWL and MFS Diversified.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. 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 14 to 22 of this Ruling.

6. This Ruling does not address the possibility of scrip for scrip roll-over relief under Subdivision 124-M in relation to this scheme should roll-over be available and should VWL Shareholders choose to claim it. The Commissioner understands that the value attributable to the MFS Diversified shares acquired under the scheme is such that the effect of any possible scrip for scrip roll-over relief under Subdivision 124-M is negligible.

7. 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.

Date of effect

9. This Ruling applies from 1 August 2006 to 30 June 2007. 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.

10. 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.

11. 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)).

12. 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.

13. 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).

Scheme

14. The scheme that is the subject of the Ruling is described below. The description is based on the following documents provided by the applicant:

- MFS Diversified's Bidder Statement dated 28 July 2006;
- VWL's Target Statement dated 1 August 2006;
- the application for Class Ruling from PricewaterhouseCoopers dated 12 February 2007; and
- correspondence received from PricewaterhouseCoopers from 8 May 2007 to 21 September 2007.

15. On 21 April 2006, MFS Diversified announced that it was in merger negotiations with VWL. On 31 May 2006, MFS Diversified announced an off market offer (the Offer) for all of the shares in VWL that MFS Diversified did not already own, to create a larger, diversified and integrated property group.

16. The Offer date was 1 August 2006. The consideration offered for each VWL ordinary share was one new ordinary share in MFS Diversified and one unit in MFS Trust (that together form a MFS Diversified Group (MFT) stapled security), plus Cash Consideration totalling $0.80. The Cash Consideration comprised a $0.60 cash payment by MFS Diversified and a $0.20 fully franked special dividend to be paid by VWL.

17. As part of the merger process, MFS Diversified was to provide funds to VWL to use to pay the special dividend to VWL shareholders. The special dividend was to be paid by VWL as soon as practicable after the Offer was declared free from all conditions by MFS Diversified and, in any event, no later than the payment of the other consideration under the Offer.

18. The Offer provided that, in the event that VWL was unable to pay the $0.20 fully franked special dividend, MFS Diversified was to make an additional $0.20 cash payment (an unfranked amount). However, VWL paid the special dividend, using bridging finance provided by MFS Diversified.

19. The ex-dividend record date for the $0.20 special dividend was 12 October 2006 with a payment date of 20 October 2006. MFS Diversified did not register the transfer of the VWL shares until after the record date to ensure that VWL Shareholders remained entitled to the special dividend. Once MFS Diversified declared the Offer free from all conditions, VWL Shareholders were issued with MFT stapled securities.

20. The compulsory acquisition thresholds were met on 22 September 2006, following which MFS Diversified sent compulsory acquisition notices on 30 October 2006 to all VWL Shareholders who had not accepted the Offer.

21. VWL Shareholders retained their entitlement to receive the VWL special dividend and had no further entitlements in respect of their VWL shares. MFT stapled securities issued to VWL Shareholders under the Offer ranked equally in all respects to all MFT stapled securities on issue at that time.

22. Foreign shareholders accepting the Offer had their MFT stapled securities issued to an ASIC approved nominee and that nominee was instructed to sell the MFT stapled securities. The net proceeds were distributed to those foreign shareholders.

Ruling

23. CGT event A1 happened when a VWL Shareholder disposed of their VWL share for a MFS Diversified share and a MFS Trust unit that comprised the MFT stapled security (section 104-10).

24. The capital proceeds received by each VWL Shareholder from the sale of each of their VWL shares was the total of the market value (on the day the shareholder disposed of their VWL shares) of one MFS Diversified share and one MFS Trust unit, and the $0.80 Cash Consideration (comprising the $0.60 cash payment received from MFS Diversified and the $0.20 special dividend received from VWL) (section 116-20).

25. Any capital gain made by the VWL Shareholder when CGT event A1 happened can be reduced by the amount of the special dividend that was included in the VWL Shareholder's assessable income under subsection 44(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) (section 118-20 of the ITAA 1997).

26. The first element of the cost base or reduced cost base of each of the MFS Diversified shares and the MFS Trust units acquired by the VWL Shareholder will be a reasonable portion of the market value of their VWL share (on the day the shareholder disposed of their VWL shares) given to acquire the MFS Diversified share and the MFS Trust unit (subsections 110-25(2) and 110-55(2)). However, the market value of the VWL share given to acquire the MFS Diversified share and the MFS Trust unit will first be reduced by the amount that is reasonably attributable to the Cash Consideration comprising the $0.60 cash and the $0.20 special dividend received (subsection 112-30(1)).

Commissioner of Taxation
24 October 2007

Appendix 1 – Explanation

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.

Capital proceeds from the disposal of VWL Shares

27. CGT event A1 happened when the VWL Shareholder exchanged their VWL share for a MFS Diversified share, a MFS Trust unit and the Cash Consideration.

28. CGT event A1 happens at the time the contract for the disposal is entered into or, if there is no contract, when the change of ownership occurs (subsection 104-10(3)).

29. The VWL Shareholder therefore disposed of their VWL shares at the time the VWL Shareholder accepted the Offer. If MFS Diversified compulsorily acquired the VWL shares, the VWL Shareholder disposed of their VWL shares at the time the shares were acquired by MFS Diversified (subsection 104-10(3)).

30. The VWL Shareholder will make a capital gain if the capital proceeds from the disposal of their VWL share are more than the cost base of that VWL share. If the capital proceeds are less than the reduced cost base of their VWL share, the VWL Shareholder will make a capital loss (subsection 104-10(4)).

31. The capital proceeds from the disposal of the VWL share will be the total of the money and the market value of any property that the VWL Shareholder receives or is entitled to receive in respect of CGT event A1 happening, worked out at the time of the event (section 116-20).

32. The VWL Shareholder received a MFS Diversified share, a MFS Trust unit and Cash Consideration of $0.80, comprising $0.60 cash and a special dividend of $0.20 which MFS Diversified caused VWL to pay, for each VWL share that they disposed of to MFS Diversified.

33. The term 'in respect of the event happening' in section 116-20 requires that the relationship between the event and the receipt of the money, or entitlement to receive the money, must be more than coincidental. An amount is not 'capital proceeds' of an event merely because it is received in association with the event. The payment of the additional cash of $0.20, whether by way of a special dividend paid by VWL or by a cash payment made by MFS Diversified, was a term of the Offer.

34. In this particular case, the special dividend of $0.20 represented part of the total price agreed to between the VWL Shareholders and MFS Diversified. The entire amount of the special dividend is reasonably attributable to the CGT event.

35. Accordingly, the special dividend of $0.20 forms part of the capital proceeds received by the VWL Shareholders for the disposal of their VWL shares.

Anti-overlap provisions

36. The special dividend of $0.20 will be included in the assessable income of the VWL Shareholders (subsection 44(1) of the ITAA 1936).

37. Because the special dividend of $0.20 will be included as assessable income, any potential double taxation that could arise for VWL Shareholders from the disposal of their VWL shares is avoided by the operation of the anti-overlap provisions in section 118-20.

38. A capital gain that a taxpayer makes from a CGT event is reduced if the capital gain includes an amount that is also included in their assessable income under a non-CGT provision (section 118-20). This has the effect of reducing the capital gain by the amount that is also assessable under the non-CGT provision.

39. Accordingly, as the special dividend of $0.20 will be included in the VWL Shareholder's assessable income under subsection 44(1) of the ITAA 1936, the VWL Shareholder can reduce the amount of any capital gain made from the disposal of their VWL shares by the amount assessable under subsection 44(1).

40. The VWL Shareholder will also include in their assessable income the amount of the franking credit in relation to the special dividend (subsection 207-20(1)). However, under paragraph 118-20(1B)(b), the capital gain made by the VWL shareholder will not be reduced by the amount of the franking credit that is included in their assessable income.

Cost base and reduced cost base of a MFT stapled security

41. The cost base or reduced cost base of the MFS Diversified share and the MFS Trust unit consists of five elements (subsections 110-25(1) and 110-55(1)).

42. Subsections 110-25(2) and 110-55(2) state that the first element of the cost base or reduced cost base of a CGT asset is the total of any money paid, or required to be paid, and the market value of any other property given, or required to be given, in respect of acquiring the asset.

43. A VWL Shareholder acquired their MFS Diversified shares and MFS Trust units at the time the VWL Shareholder entered into the contract to acquire the shares and units, that is, when the VWL Shareholder accepted the Offer. If MFS Diversified compulsorily acquired the VWL shares, the VWL Shareholder acquired their MFS Diversified shares and MFS Trust units when the shares and units were issued to them (Division 109).

44. Accordingly, the first element of the cost base or reduced cost base of each of the MFS Diversified share and the MFS Trust unit acquired by the VWL Shareholder will be a reasonable portion of the market value, on the date of the acquisition, of the VWL share given to acquire the MFS Diversified share and the MFS Trust unit.

45. However, in determining the first element of the cost base or reduced cost base of the MFS Diversified share and the MFS Trust unit, the market value of the VWL share will first be reduced by the amount that is reasonably attributable to the Cash Consideration comprising the $0.60 cash and the $0.20 special dividend (subsection 112-30(1)).

46. In this instance, that part of the market value of the VWL share that is reasonably attributable to the Cash Consideration comprising the $0.60 cash and the $0.20 special dividend is $0.80.

47. The market value of the VWL share, reduced by the Cash Consideration will then be apportioned on the basis of the amount that is reasonably attributable to the acquisition of the MFS Diversified share and the amount that is reasonably attributable to the acquisition of the MFS Trust unit (subsection 112-30(1)).

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Subject references:

- arrangement
- assessable dividend
- capital
- capital gains tax
- capital proceeds
- CGT event
- company
- cost base
- first element of cost base
- interests
- special dividend
- stapled security

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1997 104-10
- ITAA 1997 104-10(3)
- ITAA 1997 104-10(4)
- ITAA 1997 Division 109
- ITAA 1997 110-25(1)
- ITAA 1997 110-25(2)
- ITAA 1997 110-55(1)
- ITAA 1997 110-55(2)
- ITAA 1997 112-30(1)
- ITAA 1997 116-20
- ITAA 1997 118-20
- ITAA 1997 118-20(1B)(b)
- ITAA 1997 Subdiv 124-M
- ITAA 1997 207-20(1)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)

ATO references

NO:	2007/18040
ISSN:	1445-2014
ATOlaw topic:	Income Tax ~~ Capital Gains Tax ~~ CGT event A1 - disposal of a CGT asset Income Tax ~~ Capital Gains Tax ~~ cost base and reduced cost base