


# ***CR 2013/20 - Income tax: merger of Cromwell Property Fund and Cromwell Property Group***

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# Class Ruling

## Income tax: merger of Cromwell Property Fund and Cromwell Property Group

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### **ⓘ 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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);
- section 109-10 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- section 112-30 of the ITAA 1997;
- Subdivision 115-A of the ITAA 1997; and
- section 116-20 of the ITAA 1997.

All subsequent legislative references are to the ITAA 1997, unless otherwise specified.

## Class of entities

3. The class of entities to which this Ruling applies is Cromwell Property Fund (CPF) unit holders who:

- (a) participated in the Merger and received the Merger Consideration for the disposal of their CPF units;
- (b) held their CPF units on capital account;
- (c) have not applied for, or are not eligible for, scrip for scrip roll-over under Subdivision 124-M;
- (d) were residents of Australia within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* on the Record Date;
- (e) were not a 'temporary resident' of Australia within the meaning of subsection 995-1; and
- (f) were not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their CPF units.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, a person belonging to this class of entities is referred to as a 'CPF unit holder'.

## Qualifications

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

5. The Commissioner's conclusions in this Ruling are dependent on all information relied upon being complete and accurate in all material aspects. Particularly, the market value calculations would only be accurate if there is no material change in the effective net tangible assets before and after the Merger.

6. 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 10 to 26 of this Ruling.

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.

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## Date of effect

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9. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling *TR 2006/10*).

## Scheme

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

- class ruling application dated 29 October 2012;
- amended class ruling application dated 5 November 2012;
- Explanatory Memorandum and Notice of Meeting dated 7 September 2012;
- Master Unit Trust Transfer Form for the Scheme;
- calculation of the one day Volume Weighted Average Price (VWAP) of one Cromwell Security on 4 October 2012; and
- management accounts of Cromwell Diversified Property Trust (DPT) and Cromwell Corporation Ltd (CCL) as at 30 September 2012 (adjusted for the impact of the Merger on 4 October 2012).

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

## Relevant Entities

### ***Cromwell Property Fund***

11. CPF is an unlisted property trust that invests in non-residential property assets in Australia. CPF is a managed investment scheme pursuant to the *Corporations Act 2001*.

12. CPF was established in 2006.

13. The responsibility entity of CPF is Cromwell Property Securities Ltd, a wholly owned subsidiary of CCL.

14. Prior to 4 October 2012, the Implementation Date of the Merger:

- DPT held 30,020,400 CPF units (approximately 17.6% of all of the fully paid ordinary units of CPF); and
- external unit holders held 140,731,484 CPF units (approximately 82.4% of all of the fully paid ordinary units of CPF).

### ***Cromwell Property Group***

15. Cromwell Property Group (Cromwell) is an Australian Securities Exchange (ASX) listed stapled security comprising of one ordinary share in CCL and one ordinary unit in DPT (Cromwell Security).

16. CCL (together with its subsidiaries) is a funds manager of a portfolio of property trusts, one of which is CPF.

## Disposal of CPF Units

### ***The Merger***

17. On 31 August 2012, Cromwell signed a merger implementation agreement to acquire, by way of a trust scheme, all of the units in CPF that it did not already own (Merger).

18. All CPF unit holders other than DPT who held units on 1 October 2012 at 5.00pm (Record Date) were entitled to participate in the Merger. The terms of the Merger were documented in the Explanatory Memorandum dated 7 September 2012.

19. On 3 October 2012, resolutions to accept the proposed Merger were passed by the requisite majority of CPF unit holders. The approval of the resolutions deemed all CPF unit holders to have accepted the Merger and its implementation.

20. The Merger was implemented on 4 October 2012 (Implementation Date). On that date, all CPF unit holders transferred their CPF units to DPT.

21. After the Merger, the existing Cromwell security holders will hold approximately 97.3% of the Cromwell Securities, and the CPF unit holders that transferred their CPF units to DPT will hold the remaining 2.7%.

### ***Merger Consideration***

22. All CPF unit holders, other than foreign unit holders, were entitled to receive 0.2298 Cromwell Securities for each CPF unit held on the Record Date (Merger Consideration).

23. The Merger Ratio of 0.2298 was calculated by dividing the Net Tangible Assets for one CPF unit as at 30 June 2012 (\$0.1546) by the Net Tangible Assets of one Cromwell Security as at 30 June 2012 (\$0.6727), adjusted for transaction costs in both cases.

24. The Commissioner considers the Net Tangible Assets valuation methodology to be suitable in this instance given the principal operating activity of Cromwell and CPF (that is, primarily real estate investments).

### ***Foreign Unit Holders***

25. Foreign CPF unit holders were not eligible to receive Cromwell Securities under the Merger. These unit holders received cash for the disposal of their CPF units to DPT.

### ***Other Matters***

26. At the time of the Merger, an amount was paid by DPT to CCL as subscription proceeds on behalf of the existing CPF unit holders that are issued ordinary shares in CCL as part of the Merger Consideration. This payment was required as subscription proceeds on the basis that all of the CPF units were acquired by DPT but consideration was provided by way of an issue of ordinary units in DPT as well as ordinary shares in CCL.

## **Ruling**

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### **Disposal of CPF units**

27. CGT event A1 happened when CPF unit holders disposed of their CPF units to DPT under the Merger as described in this Ruling (subsections 104-10(1) and 104-10(2)).

28. The time of the CGT event was when the CPF units were transferred to DPT on the Implementation Date (subsection 104-10(3)).

## **Capital gain or capital loss**

29. A CPF unit holder made a capital gain when CGT event A1 happened if the capital proceeds from the disposal of each CPF unit exceeded its cost base. A CPF unit holder made a capital loss if the capital proceeds were less than the reduced cost base of the CPF unit (subsection 104-10(4)).

## **Capital proceeds**

30. The capital proceeds from the disposal of each CPF unit is the market value of the Cromwell Security received in exchange for the CPF unit worked out at the time that CGT event A1 happened (subsection 116-20(1)).

31. The Commissioner accepts that the capital proceeds from the disposal of each CPF unit is \$0.176985.

## **Discount capital gain**

32. A CPF unit holder who made a capital gain is eligible to treat the capital gain as a 'discount capital gain' provided that the conditions in Subdivision 115-A are satisfied.

## **Cost base of each ordinary share in CCL**

33. The first element of the CPF unit holder's cost base and reduced cost base of each ordinary share in CCL is equal to the market value of the CPF units that were exchanged for the CCL share. The market value of the CPF units is worked out at the time of the acquisition of the CCL share on the Implementation Date (subsections 110-25(2) and 110-55(2) and section 112-30).

34. The Commissioner accepts that the first element of the cost base and reduced cost base of each CCL share is \$0.02092.

## **Cost base of each ordinary unit in DPT**

35. The first element of the CPF unit holder's cost base and reduced cost base of each ordinary unit in DPT is equal to the market value of the CPF units that were exchanged for the DPT unit. The market value of the CPF units is worked out at the time of the acquisition of the DPT unit on the Implementation Date (subsections 110-25(2) and 110-55(2) and section 112-30).

36. The Commissioner accepts that the first element of the cost base and reduced cost base of each DPT unit is \$0.74925.

**Acquisition date of CCL shares and DPT units**

37. The acquisition date of the CCL shares and DPT units received in exchange for the CPF units is the date that the CCL shares and DPT units were issued to the CPF unit holders (item 2 of the table in section 109-10), which is the Implementation Date of 4 October 2012.

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**Commissioner of Taxation**20 March 2013

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## 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.*

### **Valuation methodology for determining the market value of each Cromwell Security on 4 October 2012**

38. The ATO market valuation guide for tax purposes is supportive of the use of a one day VWAP methodology for valuing listed securities. Cromwell Securities are listed on the ASX.

39. The Commissioner accepts that the market value price of Cromwell Security is \$0.77017 (based on the one day VWAP on the Implementation Date).

### **Capital proceeds**

40. The CPF unit holders received 0.2298 Cromwell Security for each CPF unit transferred to DPT.

41. Accordingly, the capital proceeds for each CPF unit received pursuant to the Merger should be calculated as follows:

One day VWAP of Cromwell Security x Number of Cromwell Security issued per CPF unit

\$0.77017 x 0.2298

= \$0.176985

42. The Commissioner accepts that the capital proceeds from the disposal of each CPF unit is \$0.176985.

### **Cromwell Security**

43. Although the Cromwell Security is a stapled security, it comprises two separate and distinct CGT assets for Australian income tax purposes (section 108-5). It consists of an ordinary share in CCL and an ordinary unit in DPT.

44. The respective cost base and reduced cost base of these CGT assets need to be worked out separately. The first element of the cost base and reduced cost base of each CGT asset is that part of the expenditure that is reasonably attributable to the acquisition of the asset (subsection 112-30(1)).

45. In respect of the Merger, the Commissioner accepts that a reasonable method of apportionment of the first element of the cost base and reduced cost base of the respective CCL share and DPT unit should be based on the relative net assets of each entity against the total net assets of Cromwell on the Implementation Date. The selection of a Net Tangible Assets methodology for a business with a primary operating activity of investing in financial assets or property is considered reasonable.

***The first element of the cost base of each ordinary share in CCL***

46. The Commissioner accepts that the amount of \$0.02092 is a reasonable indication of the first element of the cost base and reduced cost base of a CCL share worked out under the following method:

**A x B/C**

Where:

**A** is the cost base of each Cromwell Security on 4 October 2012 (Implementation Date);

**B** is the net assets of CCL on 30 September 2012 (adjusted for the Merger); and

**C** is the sum of the net assets of CCL and DPT on 30 September 2012 (adjusted for the Merger).

$$\begin{aligned} & \$0.77017 \times \frac{\$22,198,000}{\$22,198,000 + \$794,946,000} \\ & = \$0.02092 \end{aligned}$$

The Commissioner will accept that this represents the market value of the CPF units given in exchange for a CCL share.

***The first element of the cost base of each ordinary unit in DPT***

47. Similarly, the Commissioner accepts that the first element of the cost base and reduced cost base of each ordinary unit in DPT that the CPF unit holders received is \$0.74925 calculated as follows:

**A x B/C**

Where:

**A** is the cost base of the Cromwell Security on 4 October 2012 (Implementation Date);

**B** is the net assets of DPT on 30 September 2012 (adjusted for the Merger); and

**C** is the sum of the net assets of CCL and DPT on 30 September 2012 (adjusted for the Merger)

$$\begin{aligned} & \$0.77017 \times \frac{\$794,946,000}{\$22,198,000 + \$794,946,000} \\ & = \$0.74925 \end{aligned}$$

The Commissioner will accept that this represents the market value of the CPF units given in exchange for a DPT unit.

## **Appendix 2 – Detailed contents list**

48. 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

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- acquisition date
- capital gains
- capital gains tax
- CGT capital proceeds
- CGT cost base
- CGT discount
- CGT event A1 – disposal of a CGT asset

*Legislative references:*

- ITAA 1936 6(1)
- ITAA 1997 104-10
- ITAA 1997 104-10(1)
- ITAA 1997 104-10(2)
- ITAA 1997 104-10(3)

- ITAA 1997 104-10(4)
- ITAA 1997 108-5
- ITAA 1997 109-10
- ITAA 1997 110-25
- ITAA 1997 110-25(2)
- ITAA 1997 110-55
- ITAA 1997 110-55(2)
- ITAA 1997 112-30
- ITAA 1997 112-30(1)
- ITAA 1997 Subdiv 115-A
- ITAA 1997 116-20
- ITAA 1997 116-20(1)
- ITAA 1997 Subdiv 124M
- ITAA 1997 Div 230
- ITAA 1997 995-1
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001

*Other references:*

Market valuation for tax purposes

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ATO references

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