CR 2014/101 - Income tax: unit for unit roll-over: exchange of retail units in LHP Diversified Investments Fund for wholesale units

Class Ruling

Income tax: unit for unit roll-over: exchange of retail units in LHP Diversified Investments Fund for wholesale units

Contents Para

LEGALLY BINDING SECTION:

What this Ruling is about 1

Date of effect 7

Scheme 8

Ruling 30

NOT LEGALLY BINDING SECTION:

Appendix 1:

Explanation 38

Appendix 2:

Detailed contents list 55

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), and
- Subdivision 124-E of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies is the holders of retail class units in the LHP Diversified Investments Fund (DIF) who:

(a) are residents of Australia within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936*

(b) are listed on the unit register of the DIF as at 30 September 2014 at 5:00pm

(c) have their retail class units in the DIF redeemed on 30 September 2014 and are issued with replacement wholesale class units to the same value in the DIF with effect from 30 September 2014

(d) hold their retail class units in DIF on capital account at the time of the exchange (and not as trading stock or revenue assets)

(e) are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their DIF units

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

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 8 to 29 of this Ruling.

6. 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

7. This Ruling applies from 1 July 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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

8. 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 6 November 2014;
- Product Disclosure Statement for DIF dated 3 February 2014;
- Product Disclosure Statement for DIF dated 1 October 2014;
- Continuous Disclosure Notice dated 26 September 2014;
- Updated Information to PDS dated 26 September 2014;
- HFA Diversified Investments Fund Replacement Constitution dated 29 June 2009;
- LHP Diversified Investments Fund MIS Registration;
- Other information in relation to pricing methodology and the management of the trust;
- LHP Diversified Investments Fund Financial Report for the year ended 30 June 2014.

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

LHP Diversified Investments Fund

9. The LHP Diversified Investments Fund (DIF) is an Australian resident unit trust. Prior to the 30 September 2014 restructure it invested in the Lighthouse Diversified Investment Fund Limited – Class F (Lighthouse DIF), a company incorporated and tax resident in the Cayman Islands. Lighthouse DIF is managed by Lighthouse Investment Partners LLC, a company incorporated and tax resident in the United States of America.

10. The responsible entity of DIF is Certitude Global Investments Ltd (Certitude), an Australian resident company that is a subsidiary member of the HFA Holdings Ltd (HFA) tax consolidated group. HFA is an ASX listed company.

11. The current master custodian of DIF is BNP Paribas and the current registry provider is Link Market Services.

12. DIF is able to qualify as a managed investment trust (MIT) for the purposes of the pay as you go withholding tax rules in Subdivision 12-H of the *Taxation Administration Act 1953* (TAA 1953) if a fund payment is made by the DIF in relation to the relevant income year, and also for the purposes of the capital account election provisions in Division 275.

13. DIF made the MIT capital account election in the approved form on 2 September 2010. The election is effective from 1 July 2008 and deems all gains or losses made on the disposal of covered assets to be on capital account for income tax purposes.

14. Prior to the restructure on 30 September 2014, DIF had two separate classes of units on issue, a retail class and a wholesale class.

15. There were 655 investors in the retail class units, of which, 649 were Australian resident investors with the remaining being non-resident investors.

16. Holders of retail class units are charged a management fee of 1.52% p.a. (inclusive of GST net of RITC).

17. Holders of wholesale class units are charged a management fee of 1.27% p.a. (inclusive of GST net of RITC).

18. The management fees are calculated on the Net Asset Value of each class of units and are reflected in the monthly unit price for each class of units. These management fees are in accordance with the current Product Disclosure Statement (PDS) for DIF dated 3 February 2014.

Restructure of the DIF

19. DIF was restructured with effect from 30 September 2014.

20. DIF redeemed its entire investment in the Lighthouse Diversified Investment Fund Limited – Class F as at 5pm on 30 September 2014 for market value proceeds.

21. DIF invested the market value proceeds from the redemption of its investment in the Lighthouse Diversified Investment Fund Limited into the Lighthouse Multi-Strategy Fund on 1 October 2014. The Lighthouse Multi-Strategy Fund is a Cayman Islands incorporated and tax resident company that is also managed by Lighthouse Investment Partners LLC.

22. All of the retail class units in the DIF were redeemed on 30 September 2014.

23. The investors in retail class units in the DIF as recorded on the unit registry as at 5pm on 30 September 2014 had their retail class units redeemed. In exchange, they were allocated units in the wholesale class to the same market value of the retail class units on 30 September 2014.

24. There was no interim distribution of income by the DIF to retail class investors on 30 September 2014, that is, immediately before the date of the proposed redemption of the retail class of units.

25. Investors in retail class units received wholesale class units of an equivalent value and nothing else. The market value equivalent wholesale class units were determined using the unit price for the retail class and the unit price for the wholesale class as at 30 September 2014. This unit price was based on the Net Asset Value of investments divided by the number of units on issue as at 5.00pm on 30 September 2014.

26. As at 30 September 2014 each retail class unit was valued at $1.436227 and each wholesale class unit was valued at $1.484530.

27. Effective from 1 October 2014, the wholesale class units were renamed 'Fund units'. Note, there was only a change to the name of the wholesale class units – there was no redemption or replacement of these units. The management fee levied to holders of Fund units was reduced to 1.20% per annum (inclusive of GST net of RITC). These changes are reflected in the new PDS issued by Certitude Global Investments Limited dated 1 October 2014.

28. The continuous disclosure notices that were issued to unit holders in DIF confirm that no retail class units will be issued from 30 September 2014. All new issues of units from 1 October 2014 will be Fund units.

Other matters

29. All DIF retail units were acquired on or after 20 September 1985, and as a consequence no unit holder held pre-CGT units at 5pm on 30 September 2014.

Ruling

CGT event A1 happened on the disposal of DIF retail units

30. CGT event A1 happens when a DIF retail unit holder disposes of their retail units in exchange for DIF wholesale units of an equivalent value (and nothing else) at 5pm on 30 September 2014 (subsections 104-10(1) and 104-10(2) and paragraph 104-10(3)(b)).

Capital gain or capital loss

31. A DIF retail unit holder makes a capital gain when CGT event A1 happens if the capital proceeds from the disposal of their DIF retail unit exceeds its cost base. The capital gain is the amount of the excess. A DIF retail unit holder will make a capital loss if the capital proceeds on disposal are less than the reduced cost base of the DIF retail unit. The capital loss is the amount of the difference (subsection 104-10(4)).

32. For a DIF retail unit holder, the capital proceeds for each DIF retail unit will be the market value of the DIF retail unit, worked out as at the time that CGT event A1 happened (subsection 116-20(1)).

33. The market value of a DIF retail unit is determined based on the unit pricing methodology. The Commissioner accepts that each retail unit has a market value of $1.436227.

If a capital gain is made

If unit for unit roll-over is chosen

34. If a DIF retail unit holder chooses unit for unit roll-over, the capital gain or capital loss made from the disposal of their DIF retail unit is disregarded (subsection 124-15(2)).

35. A DIF retail unit holder who does not, or cannot, choose unit for unit roll-over must take any capital gain or capital loss from the disposal of their units into account in working out their net capital gain or net capital loss for the income year.

Acquisition date of DIF wholesale units

36. A DIF retail unit holder who chooses unit for unit roll-over is taken to have acquired their replacement DIF wholesale units on the date they originally acquired their DIF retail units that were exchanged (Item 2 of the table in subsection 115-30(1)).

37. A DIF retail unit holder who does not, or is unable, to choose unit for unit roll-over will acquire the DIF wholesale units with effect from 30 September 2014.

Commissioner of Taxation
10 December 2014

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.

Availability of unit for unit roll-over

38. Subdivision 124-E enables a unit holder who owns original units of a certain class to disregard a capital gain or capital loss from a unit from that class when all the units of that class are redeemed or cancelled and the trustee issues the unit holder with a replacement unit (and nothing else) in substitution for the original unit. It also provides special rules for calculating the cost base of the replacement units.

39. Subdivision 124-E contains a number of conditions that must be satisfied before a unit holder is eligible to choose unit for unit roll-over. These conditions are:

- the unit holder owns the units (the original units) of a certain class in a unit trust;
- the trustee redeems or cancels all units of that class;
- the trustee issues the unit holder with new units (and nothing else) in substitution for the original units;
- the market value of the new units just after they were issued is at least equal to the market value of the original units just before they were redeemed or cancelled; and
- the unit holder is an Australian resident at the time of the redemption or cancellation or, if they are a foreign resident at the time, the original units were taxable Australian property just before that time and the new units are taxable Australian property when they are issued.

Requirement 1 – Investor owns units of a certain class in a unit trust

40. In the present case, the participating investors owned units in the retail class of DIF. The DIF is an MIT for the purposes of the pay as you go withholding tax rules in Subdivision 12-H of the TAA 1953 and also for the purposes of the capital account election provisions in Division 275 of the ITAA 1997. DIF made the capital account election in the approved form on 2 September 2010 effective from 1 July 2008. This election deems all gains or losses made on the disposal of covered assets to be on capital account for income tax purposes.

41. Clause 3.5 of the Constitution of DIF dated 30 June 2009 allows the DIF to issue units in various classes.

42. The first requirement is satisfied.

Requirement 2 – The trustee redeems or cancels all units of that class

43. Under the Scheme the Trustee of DIF, Certitude, redeemed all of the units in the retail class of DIF. No further retail units will be issued after the redemption.

44. The second requirement is satisfied.

Requirement 3 – The trustee issues the taxpayer with new units in substitution for the original units

45. After the retail units in DIF were redeemed, Certitude, as the Trustee of DIF, provided those investors in the retail class of DIF with units in the wholesale class of DIF equivalent to the market value of their redeemed units. The DIF retail unit holders received nothing else other than these wholesale units.

46. The third requirement is satisfied.

Requirement 4 – The market value of the new units just after they were issued is at least equal to the market value of the original units just before they were redeemed or cancelled

47. Certitude, as the Trustee of DIF, issued the retail class investors with new units in the wholesale class of an equivalent market value to the redeemed units in the retail class of DIF.

48. The market value of the new units and the market value of the original units is the value determined pursuant to the unit pricing calculations prepared by Certitude on the last day of each month. The unit pricings are based on the Net Asset Value of the investments in each class divided by the number of units.

49. Applying the unit pricing methodology used by the DIF provided with the ruling application, the calculation was as follows:

$$= \frac{\text{Market value of DIF retail unit}}{\text{value of DIF wholesale unit}}$$

$$= \frac{\$1.436227}{\$1.484530}$$

$$= 0.967 \text{ wholesale class units (rounded to three decimal places)}$$

50. The fourth requirement is satisfied.

Requirement 5 – The taxpayer is an Australian resident at the time of redemption or cancellation or a foreign resident whose units were taxable Australian property

51. The class of entities to which this ruling applies are Australian resident investors.

52. The fifth requirement is satisfied.

DIF wholesale units

Calculation of cost base of DIF wholesale units

53. As all units in the DIF were acquired on or after 20 September 1985, the first element of the cost base of the unit holder's DIF wholesale units is determined as follows (subsection 124-15(3)):

$$\frac{\text{The total of the cost bases of all the original assets (worked out when your ownership of them ended)}}{\text{Number of new assets}}$$

54. Therefore, the first element of the cost base of the new wholesale class units is equal to the total cost base of the original retail class units as at the time the DIF retail class units were redeemed, divided by the number of new wholesale class units issued to the investor.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	**1**
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	**7**
Scheme	**8**
LHP Diversified Investments Fund	9
Restructure of the DIF	19
Other matters	29
Ruling	**30**
CGT event A1 happened on the disposal of DIF retail units	30
Capital gain or capital loss	31
If a capital gain is made	34
If unit for unit roll-over is chosen	34
Acquisition date of DIF wholesale units	36
Appendix 1 – Explanation	**38**
Availability of unit for unit roll-over	38
Requirement 1 – Investor owns units of a certain class in a unit trust	40
Requirement 2 – The trustee redeems or cancels all units of that class	43
Requirement 3 – The trustee issues the taxpayer with new units in substitution for the original units	45
Requirement 4 – The market value of the new units just after they were issued is at least equal to the market value of the original units just before they were redeemed or cancelled	47
Requirement 5 – The taxpayer is an Australian resident at the time of redemption or cancellation or a foreign resident whose units were taxable Australian property	51
DIF wholesale units	53
Calculation of cost base of DIF wholesale units	53
Appendix 2 – Detailed contents list	**55**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- CGT cost base
- CGT events
- CGT event A1 – disposal of a CGT Asset
- Managed investment trusts
- Unit trusts
- Unit for unit roll-over

Legislative references:

- ITAA 1936 6(1)
- ITAA 1997
- ITAA 1997 104-10
- ITAA 1997 104-10(1)
- ITAA 1997 104-10(2)
- ITAA 1997 104-10(3)(b)
- ITAA 1997 104-10(4)
- ITAA 1997 115-30(1)
- ITAA 1997 116-20(1)
- ITAA 1997 124-15(2)
- ITAA 1997 124-15(3)
- ITAA 1997 Subdiv 124-E
- ITAA 1997 Div 230
- ITAA 1997 Div 275
- TAA 1953
- TAA 1953 Subdiv 12-H

ATO references

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