


# ***CR 2016/79 - Income tax: Patties Foods Limited Scheme of Arrangement and Payment of Special Dividend***

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## Class Ruling

### Income tax: Patties Foods Limited Scheme of Arrangement and Payment of Special Dividend

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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, 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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

### Relevant provisions

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

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) of the ITAA 1936.
- section 128B of the ITAA 1936
- section 128D of the ITAA 1936
- Division 1A of former Part IIIA of the ITAA 1936
- former section 160APHE of the ITAA 1936
- former section 160APHO of the ITAA 1936
- former section 160APHN of the ITAA 1936

- section 177E of the ITAA 1936
- section 177EA of the ITAA 1936
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 67-25 of the ITAA 1997
- section 104-10 of the ITAA 1997
- Division 115 of the ITAA 1997
- subsection 116-20(1) of the ITAA 1997
- Subdivision 124-M of the ITAA 1997
- section 202-40 of the ITAA 1997
- section 202-75 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 204-20 of the ITAA 1997
- subsection 207-35(1) of the ITAA 1997
- section 207-45 of the ITAA 1997
- section 207-145 of the ITAA 1997
- Division 208 of the ITAA 1997
- section 855-10 of the ITAA 1997
- section 855-15 of the ITAA 1997, and
- section 855-25 of the ITAA 1997.

All subsequent legislative references in this Ruling are to provisions of the ITAA 1997 unless specified otherwise.

## **Class of entities**

3. The class of entities to which this Ruling applies are the shareholders of Patties Foods Limited (Patties) who:

- are residents or non-residents of Australia (other than non-residents who carry on a business at or through a permanent establishment in Australia) as defined in subsection 6(1) of the ITAA 1936
- held their shares on capital account, that is the shares were neither held as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1))
- disposed of their shares in Patties (to Australasian Foods Bidco Pty Ltd) pursuant to Part 5.1 of the *Corporations Act 2001* (Corporations Act) scheme of arrangement (as described in paragraphs 9 to 32 of

this Ruling (the Scheme) and received the Special Dividend and/or the Scheme Consideration pursuant to the scheme

- are not significant stakeholders or common stakeholders within the meaning of those expressions in Subdivision 124-M, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Patties shares.

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

4. In this Ruling, an entity belonging to this class of entities is referred to as a Scheme Shareholder.

### **Qualifications**

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

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 9 to 32 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.

### **Date of effect**

8. This Ruling applies from 1 July 2016 to 30 June 2017. The Ruling continues to apply after 30 June 2017 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**

9. The following description of the scheme is based on information provided by the applicant.

**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

### *Patties*

10. Patties is an Australian resident company that has been listed on the Australian Securities Exchange (ASX) since November 2006.
11. Patties' principal activities comprise the manufacturing of meat pies, baked goods and pre-made desserts.
12. On 27 May 2016, Patties had 139,312,537 ordinary shares on issue and 1,191,338 performance rights if certain criteria are met.
13. As at 30 June 2016, approximately 26% of Patties shares were held by foreign resident entities and approximately 74% of Patties shares were held by Australian resident entities.
14. No non-residents, either alone or together with any associates, beneficially held more than 10% of the shares in Patties.

### *Bidco*

15. Australasian Foods Bidco Pty Limited (Bidco) was incorporated in Australia on 26 May 2016 and is a wholly owned subsidiary of Australasian Foods Finco Pty Limited (Finco). Finco was also incorporated in Australia on 26 May 2016 and is a wholly owned subsidiary of Australasian Foods Holdco Pty Ltd (Holdco), an entity incorporated in Australia on 26 May 2016.
16. Each of Bidco, Finco and Holdco is a proprietary company limited by shares that was incorporated specifically for the purpose of the acquisition of Patties shares.
17. Bidco is beneficially owned by funds managed or advised by Pacific Equity Partners Pty Ltd (PEP) or its affiliates. PEP is a private equity advisory firm that has been investing in the Australian and New Zealand markets since 1998.
18. Prior to the Scheme Implementation Date neither Bidco, Finco, Holdco or PEP held any Patties shares.

## The Scheme

19. On 2 June 2016, Patties announced that it had executed a Scheme Implementation Deed (SID) with Bidco on 1 June 2016 under which PEP, through a wholly-owned subsidiary (Bidco) would acquire all Patties shares pursuant to Part 5.1 of the Corporations Act.

20. The Scheme is subject to certain conditions precedent set out in the SID including, but not limited to:

- Scheme Shareholder approval, and
- Court approval by the Supreme Court of Victoria.

21. The Scheme was approved by a majority of Patties' eligible shareholders at the Scheme Meeting held on 26 August 2016. Final Court orders were obtained on 2 September 2016.

22. The Explanatory Booklet was registered by Patties with ASIC on the 18 July 2016. Entitlement to the Special Dividend (Special Dividend Record Date) was determined on 8 September 2016 and the entitlement to the Scheme Consideration (Scheme Record Date) was 15 September 2016. The implementation date of the Scheme was 22 September 2016 (Scheme Implementation Date).

23. The market value of a Patties share on the Scheme Implementation Date was \$1.42.

24. The Explanatory Booklet included an independent expert's report which advised that the market value of a Class B Share on the Scheme Implementation Date was between \$0.79 and \$1.06.

25. Under the scheme, participating Scheme Shareholders who disposed of a Patties share to Bidco and were not non-residents either:

- made an election to receive a Class B share in Holdco in consideration for their Patties share (Scrip Consideration), or
- did not make an election to receive Scrip Consideration for their Patties share, in which case they received \$1.65 for that share less the amount of any Special Dividend paid for that share (Cash Consideration).

26. Scheme Shareholders who were non-residents could not elect to receive Scrip Consideration for any of their Patties shares and received Cash Consideration for each of their Patties shares.

27. Scheme Shareholders who elected to receive Scrip Consideration had to specify the percentage of their Patties shares in respect of which they were electing to receive Scrip Consideration for within a range of 40% to 100% of the total number of Patties shares they held. Scheme Shareholders received Cash Consideration for each Patties share that they had not made an election to receive Scrip Consideration for.

28. The SID was subject to regulatory approvals from the Foreign Investment Review Board (FIRB) and the Australian Securities and Investments Commission (ASIC).

## **Special Dividend**

29. On 2 September 2016, the Board of Directors of Patties declared a fully franked Special Dividend of \$0.25 to Scheme Shareholders for every Patties share they held on the Special Dividend Record Date of 8 September 2016. The Special Dividend Payment Date was 14 September 2016.

30. The declaration of the Special Dividend was conditional upon the approval of the Scheme by the Supreme Court of Victoria, which was obtained on 2 September 2016. Neither Bidco nor PEP influenced the decision of the Patties Board of Directors to declare the Special Dividend.

31. The Special Dividend was paid out of retained earnings derived by Patties and was funded by Patties from existing cash reserves and from Patties existing external financiers. Bidco did not provide any funds to Patties to finance the Special Dividend. The Special Dividend was not debited against Patties' share capital account.

## **Scheme Consideration**

32. Under the Scheme, Scheme Shareholders who elected to receive Scrip Consideration for a Patties share received one Class B Share for that Patties share and, if they held the Patties share on the record date for the Special Dividend, the amount of the Special Dividend in respect of the Patties share. Scheme Shareholders who received Cash Consideration for a Patties share received a cash payment for that Patties share equal to \$1.65 less the amount of the Special Dividend determined by Patties.

# **Ruling**

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## **The Special Dividend**

33. The Special Dividend paid to Scheme Shareholders is a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

## **Assessability of the Special Dividend**

34. Scheme Shareholders who received the Special Dividend and are residents of Australia as defined in subsection 6(1) of the ITAA 1936 are required to include the Special Dividend as assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

35. Scheme Shareholders who received the Special Dividend and are non-residents (other than those carrying on business in Australia at or through a permanent establishment in Australia) are not required to include the dividend as assessable income under subparagraph 44(1)(b)(i) of the ITAA 1936 (section 128D of the ITAA 1936) and will not be liable for Australian withholding tax (paragraph 128B(3)(ga) of the ITAA 1936).

36. A non-resident Scheme Shareholder who received the Special Dividend and is carrying on business in Australia at or through a permanent establishment in Australia, where the dividend is attributable to the permanent establishment, is required to include the dividend as assessable income under subparagraph 44(1)(c)(i) of the ITAA 1936 and is not liable to Australian withholding tax in respect of the dividend (subsection 128B(3E) of the ITAA 1936).

### **Gross up and tax offset**

37. The Special Dividend is a frankable distribution under section 202-40.

38. A Scheme Shareholder who received the Special Dividend directly and satisfies the residency requirements in section 207-75:

- must include the amount of the franking credit attached to the Special Dividend in their assessable income, and
- will be entitled to a tax offset equal to the franking credit,

under section 207-20, subject to being a 'qualified person' in relation to the Special Dividend.

39. A Scheme Shareholder (not being a corporate tax entity), who received the Special Dividend as a trustee of a trust (not being a complying superannuation entity) or as a partnership, is required to include an amount equal to the franking credit attached to the dividend in its assessable income under subsection 207-35(1), subject to the trustee or the partnership being a 'qualified person'.

40. The relevant members of a partnership or trust to whom a distribution flows indirectly through the partnership or trust, are entitled to a tax offset under section 207-45, equal to their share of the franking credit attached to the distribution included in the assessable income of the partnership or trust under subsection 207-35(1).

### **Qualified persons**

41. The payment of the Special Dividend will constitute a related payment for the purposes of former section 160APHN of the ITAA 1936.



42. Accordingly, to be a qualified person in relation to the Special Dividend, each Scheme Shareholder will need to hold their Patties share 'at risk' for a continuous period of at least 45 days in the secondary qualification period. A Scheme Shareholder must exclude any days on which they have materially diminished risks of loss or opportunities for gain in respect of their Patties share.

43. A Scheme Shareholder is considered to no longer hold their Patties share 'at risk' for the purposes of former Division 1A of Part IIIAA of the ITAA 1936 as from the Scheme Record Date of 15 September 2016. Therefore, a Scheme Shareholder will be a qualified person in relation to the Special Dividend if, in the period from 26 July 2016 and 14 September 2016 (inclusive), they continued to hold their Patties share and did not have materially diminished risks of loss or opportunities for gain in respect of their Patties share for a continuous period of at least 45 days (not counting the day on which the share was acquired or the day of disposal of the share).

## **Refundable tax offset**

44. The franking credit tax offset that a Scheme Shareholder is entitled to under Division 207 is subject to the refundable tax offset rules in Division 67, provided the Scheme Shareholder is not excluded by the operation of section 67-25.

## **Exempting entity**

45. Patties was not an 'exempting entity' when the Special Dividend was paid, nor was it a 'former exempting entity' at that time as less than 95% of accountable membership interest or accountable partial interest (broadly direct and indirect ownership interests) held in Patties was held by non-residents (Division 208).

46. As at 30 June 2016, the total foreign resident shareholding was approximately 26%. The percentage of resident shareholders at the time of the payment of the Special Dividend is consistent with the shareholding profile at 30 June 2016.

47. Section 208-195 will therefore not apply to deny the gross-up of the assessable income of a Scheme Shareholder by the amount of the franking credit attached to the Special Dividend received by shareholders, nor to deny the tax offset to which the Scheme Shareholder is otherwise entitled pursuant to Division 207 at the time when the Special Dividend was paid.

## **Capital Gains Tax (CGT) consequences**

### **CGT event A1**

48. CGT event A1 happens when a Scheme Shareholder disposes of each of their Patties shares to Bidco pursuant to the Scheme (section 104-10).

49. Under subsection 104-10(3), the time of CGT event A1 is when the change of the ownership occurs (paragraph 104-10(3)(b)). CGT event A1 happened when Patties shares were transferred to Bidco on the Scheme Implementation Date of 22 September 2016.

50. A Scheme Shareholder will make a capital gain when CGT event A1 happens if the capital proceeds from the disposal of the Patties share exceeds the cost base of that share. A Scheme Shareholder will make a capital loss if the capital proceeds are less than the reduced cost base of the Patties share (subsection 104-10(4)).

### ***Capital proceeds***

51. The capital proceeds from CGT event A1 will be the Cash Consideration or the market value (worked out at the time of CGT event A1) of the Class B Share received or entitled to be received by Scheme Shareholders for each Patties share (subsection 116-20(1)). The capital proceeds from CGT event A1 happening in respect of each Patties share will not include the Special Dividend.

### ***Availability of scrip for scrip roll-over if a capital gain is made***

52. Subject to the qualification in paragraph 53 of this Ruling, a Scheme Shareholder who made a capital gain from the disposal of their Patties share and received Scrip Consideration may choose scrip for scrip roll-over for that part of the capital gain that is referable to the receipt of a Class B Share (section 124-780).

53. However, scrip for scrip roll-over cannot be chosen if any capital gain the Scheme Shareholder might make from the replacement Class B Share would be disregarded, except because of a roll-over (subsection 124-795(2)).

54. If scrip for scrip roll-over is chosen, that part of the capital gain that is referable to the receipt of a Class B Share is disregarded (subsection 124-785(1)).

### ***Discount capital gain***

55. If a Scheme Shareholder makes a capital gain from the disposal of their Patties share and roll-over is not chosen, or cannot be chosen, for all or part of the gain, they will be eligible to treat that part as a 'discount capital gain' provided that:

- the Scheme Shareholder is an individual, complying superannuation entity or, subject to the rules in Subdivision 115-C, a trust (section 115-10)
- the capital gain has been worked out using a cost base that has been calculated without reference to indexation (subsection 115-20(1)), and

- the Patties share was acquired at least 12 months prior to CGT event A1 happening (subsection 115-25(1)).

## **Non-resident Scheme Shareholders**

56. A non-resident Scheme Shareholder who participates in the Scheme may disregard any capital gain or capital loss made when CGT event A1 happens if their share is not 'taxable Australian property' (section 855-10).

## **Cost base of Class B Shares**

57. The cost base and reduced cost base of a Class B Share acquired by a Scheme Shareholder in exchange for their Patties share, is affected by whether the Scheme Shareholder chooses scrip for scrip roll-over.

### ***Scrip for scrip roll-over is not chosen***

58. Where scrip for scrip roll-over is not chosen, the first element of the cost base and reduced cost base of each Class B Share is equal to the market value of each Patties share given in exchange for the acquisition of a Class B Share (subsections 110-25(2) and 110-55(2)). The market value is worked out at the time of the acquisition (subsection 110-25(2)).

### ***Scrip for scrip roll-over is chosen***

59. Where scrip for scrip roll-over is chosen, the first element of the cost base and reduced cost base of a replacement Class B Share is worked out by reasonably attributing to it the cost base of the Patties share for which it was exchanged and for which the roll-over was obtained (subsections 124-785(2) and 124-785(4)).

## **Acquisition date of Class B Shares**

60. The acquisition date of the Class B Shares will be the date when the shares are issued (Item 2 of the table in section 109-10).

61. For the purpose of determining whether a capital gain made from any later disposal of a Class B Share is a discount capital gain, Scheme Shareholders who choose scrip for scrip roll-over are taken to have acquired the Class B Share when they acquired the corresponding Patties share involved in the roll-over (Item 2 of the table in subsection 115-30(1)).

**The anti-avoidance provisions**

62. The Scheme is not a scheme, or a scheme having substantially the effect of a scheme, by way of, or in the nature of dividend stripping within the meaning of section 177E of the ITAA 1936 and the Commissioner will not make a determination under subsection 177F(1) of the ITAA 1936 to include any amount in the assessable income of Scheme Shareholders.

63. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit received in relation to the Special Dividend.

64. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit received in relation to the Special Dividend.

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**Commissioner of Taxation**19 October 2016

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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.*

### The Special Dividend

65. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 to include any distribution made by a company to any of its shareholders, whether in money or other property.

66. The payment of the Special Dividend is a distribution in money made by Patties to its shareholders.

67. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 excludes from the definition of 'dividend' any:

...moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company...

68. The payment of the Special Dividend is sourced from existing cash reserves and loan facilities. The Special Dividend will be debited against Patties' retained earnings. Patties will not debit the Special Dividend against its share capital account. Therefore, the exclusion in paragraph (d) will not apply and the Special Dividend will constitute a 'dividend' for the purposes of subsection 6(1) of the ITAA 1936.

### Assessability of the Special Dividend

#### Residents

69. Paragraph 44(1)(a) of the ITAA 1936 includes in the assessable income of an Australian resident shareholder in a company:

...dividends (other than non-share dividends) that are paid to the shareholder by the company out of profits derived by it from any source.

70. As the Special Dividend is paid to Scheme Shareholders out of profits derived by Patties, Scheme Shareholders who are residents of Australia are required to include the Special Dividend in their assessable income under paragraph 44(1)(a) of the ITAA 1936.

***Non-residents (not carrying on business at or through a permanent establishment)***

71. Subparagraph 44(1)(b)(i) of the ITAA 1936 includes in the assessable income of a non-resident shareholder in a company:

...dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia.

72. Subsection 128B(1) of the ITAA 1936 imposes Australian withholding tax on income that:

- (a) is derived, on or after 1 January 1968, by a non-resident; and
- (b) consists of a dividend paid by a company that is a resident.

73. However, subparagraph 128B(3)(ga)(i) of the ITAA 1936 excludes from subsection 128B(1) of the ITAA 1936 income derived by a non-resident that consists of the franked part of a dividend. As the Special Dividend is fully franked, it will not be subject to Australian withholding tax when derived by non-resident Scheme Shareholders.

74. In addition section 128D of the ITAA 1936 states that:

Income other than income to which section 128B of the ITAA 1936 applies by virtue of subsection (2A), (2C) or 9(C) of that section upon which withholding tax is payable, or upon which withholding tax would, but for paragraph 128B(3)(ga), (jb) or (m), section 128F, section 128FA or section 128GB, be payable, is not assessable income and is not exempt income of a person.

75. As the payment of the Special Dividend is income that is subject to withholding tax but for paragraph 128B(3)(ga) of the ITAA 1936, it will not be assessable income, and will not be exempt income of non-resident Scheme Shareholders pursuant to section 128D of the ITAA 1936.

76. Accordingly, Scheme Shareholders who receive the fully franked Special Dividend and are non-residents (other than those carrying on business in Australia at or through a permanent establishment in Australia) are not required to include the dividend as assessable income under subparagraph 44(1)(b)(i) of the ITAA 1936 (section 128D of the ITAA 1936) and will not be liable for Australian withholding tax (paragraph 128B(3)(ga) of the ITAA 1936).

***Non-residents (carrying on business at or through a permanent establishment)***

77. A non-resident's liability to withholding tax on dividend income received in subsection 128B(1) of the ITAA 1936 is subject to subsection 128B(3E). Subsection 128B(3E) states that section 128B does not apply to dividend income that:

- (a) is paid to a person who is a non-resident carrying on business in Australia at or through a permanent establishment of the person in Australia; and

- (b) is attributable to the permanent establishment; and
- (c) is not paid to the person in the person's capacity as trustee.

78. Subparagraph 44(1)(c)(i) of the ITAA 1936 includes dividends in the assessable income of a non-resident shareholder of a resident company, where the non-resident shareholder is carrying on business in Australia at or through a permanent establishment of the shareholder in Australia which:

... are attributable to the permanent establishment, to the extent to which they are paid out of profits derived by the company from sources outside Australia.

79. Accordingly, non-resident Scheme Shareholders carrying on a business in Australia at or through a permanent establishment who received the Special Dividend are required to include the dividend in their assessable income, to the extent to which the dividend is attributable to the permanent establishment, pursuant to subparagraph 44(1)(c)(i) of the ITAA 1936 and will not be liable for Australian withholding tax in relation to the dividend.

## Gross up and tax offset

80. Section 207-20 provides:

- (1) If an entity makes a \*franked distribution to another entity, the assessable income of the receiving entity, for the income year in which the distribution is made, includes the amount of the \*franking credit on the distribution. This is in addition to any other amount included in the receiving entity's assessable income in relation to the distribution under any other provision of this Act.
- (2) The receiving entity is entitled to a \*tax offset for the income year in which the distribution is made. The tax offset is equal to the \*franking credit on the distribution.

81. Therefore, subject to satisfying the qualified person rule, where the fully franked Special Dividend is received directly by a Scheme Shareholder, the Scheme Shareholder will:

- include the amount of the franking credit attached to the Special Dividend in their assessable income, and
- be entitled to a tax offset equal to the amount of the franking credit.

82. Where the fully franked Special Dividend is received by a Scheme Shareholder (not being an entity taxed as a corporate tax entity) that is a trustee of a trust (not being a complying superannuation fund) or a partnership, subsection 207-35(1) applies, subject to the trustee or partnership being a qualified person. Subsection 207-35(1) provides:

If:

- (a) a \*franked distribution is made in an income year to an entity that is a partnership or the trustee of a trust; and
- (b) the entity is not a \*corporate tax entity when the distribution is made; and
- (c) if the entity is the trustee of a trust – the trust is not a \*complying superannuation entity when the distribution is made;

the assessable income of the partnership or trust for that income year includes the amount of the \*franking credit on the distribution.

83. Therefore, subject to satisfying the 'qualified person' rule, a Scheme Shareholder that is a trust or a partnership will be required to include the amount of the franking credit attached to the Special Dividend in their assessable income under subsection 207-35(1).

### **Qualified persons, related payment and holding period rule**

#### ***Qualified person***

84. Pursuant to subsection 207-145(1), an entity must be a 'qualified person' in relation to a dividend in order to be entitled to a tax offset in respect of the franking credit on a dividend.

85. Former section 160APHU of the ITAA 1936 provides that a partner in a partnership or the beneficiary of a trust cannot be a qualified person in relation to a dividend unless the partnership or the trustee of the trust is also a qualified person in relation to the dividend.

86. Former Division 1A of Part IIIAA of the ITAA 1936 provides the statutory tests that must be satisfied for a taxpayer to be a 'qualified person' in relation to a franked distribution they have received and thus be entitled to a tax offset for the franking credit on the distribution. Former Division 1A has effect via the express terms of section 207-145.

87. The test of what constitutes a 'qualified person' is provided in former subsection 160APHO(1) of the ITAA 1936 as follows:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a ***qualified person*** in relation to the dividend if:



- (a) where neither the taxpayer nor an associate of the taxpayer has made, or is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of a taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

88. Broadly, if Scheme Shareholders are not under an obligation to make a related payment in relation to a dividend or distribution, they will have to satisfy the holding period requirement within the primary qualification period. If Scheme Shareholders are under an obligation to make a related payment in relation to a dividend or distribution, they will have to satisfy the holding period requirement within the secondary qualification period.

### ***Related payment rule***

89. In order to determine what the relevant qualification period is, it is necessary to determine whether, under the present arrangement, a Scheme Shareholder has made, or is under an obligation to make, or is likely to make, a related payment in respect of any of the dividends they receive.

90. Former section 160APHN of the ITAA 1936 gives examples of, but does not limit, what constitutes the making of a related payment, for the purposes of Division 1A of former Part IIIA of the ITAA 1936.

91. Former subsection 160APHN(2) of the ITAA 1936 states:

The taxpayer or associate is taken, for the purposes of this Division, to have made, to be under an obligation to make, or to be likely to make, a related payment in respect of the dividend or distribution if, under an arrangement, the taxpayer or associate has done, is under an obligation to do, or may reasonably be expected to do, as the case may be, anything having the effect of passing the benefit of the dividend or distribution to one or more other persons.

92. Former subsection 160APHN(3) of the ITAA 1936 states:

Without limiting subsection (2), the doing of any of the following by the taxpayer or an associate of the taxpayer in the circumstances mentioned in subsection (4) may have the effect of passing the benefit of the dividend or distribution to one or more other persons:

- (a) causing a payment or payments to be made to, or in accordance with the directions of, the other person or other persons; or

- (b) causing an amount or amounts to be credited to, or applied for the benefit of, the other person or the other persons; or
- (c) causing services to be provided to, or in accordance with the directions of, the other person or other persons; or
- (d) causing property to be transferred to, or in accordance with directions of, the other person or other persons; or
- (e) allowing any property or money to be used by the other person or other persons or by someone nominated by the other person or other persons; or
- (f) causing an amount or amounts to be set off against, or to be otherwise applied in reduction of, a debt or debts owed by the other person or other persons; or
- (g) agreeing to treat an amount or amounts owed to the other person or other persons by the taxpayer or associate as having been increased.

93. Former subsection 160APHN(4) of the ITAA 1936 states:

The circumstances referred to in subsection (3), are where:

- (a) the amount or the sum of the amounts paid, credited or applied; or
- (b) the value or the sum of the values of the services provided, of the property transferred or of the use of the property or money; or
- (c) the amount or the sum of the amounts of the set-offs, reductions or increases;

as the case may be:

- (d) is, or may reasonably be expected to be, equal to; or
- (e) approximates or may reasonably be expected to approximate; or
- (f) is calculated by reference to;

the amount of the dividend or distribution.

94. In the circumstances of this Scheme, it is considered that the payment of the Special Dividend is an integral part of the Scheme. Under the terms of the Scheme Implementation Deed, the Cash Consideration is reduced by the amount of the Special Dividend paid by Patties to Scheme Shareholders. Therefore, the former paragraphs 160APHN(3)(f) and 160APHN(4)(c) of the ITAA 1936 are satisfied.

95. The reduction of the Cash Consideration has the effect of passing the benefit of the dividends from a Scheme Shareholder to Bidco. A Scheme Shareholder, or a partner in a partnership or a beneficiary of a trust that has an interest in Patties shares, is taken to have made, or to be under an obligation to make, a related payment in respect of the Special Dividend.

## ***Holding period requirement***

96. As Scheme Shareholders are taken, for the purposes of former Division 1A, to have made or be likely to make a related payment in respect of the Special Dividend, the relevant qualification period is the secondary qualification period pursuant to former paragraph 160APHO(1)(b) of the ITAA 1936.

97. Former paragraph 160APHO(2)(a) of the ITAA 1936 provides that:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid satisfies this subsection in relation to a qualification period in relation to the shares or interest if, during the period:

- (a) where the taxpayer held the shares – the taxpayer held the shares for a continuous period (not counting the day on which the taxpayer acquired the shares or, if the taxpayer has disposed of the share, the day on which the disposal occurred) of not less than:
  - (i) if the shares are not preference shares – 45 days; or
  - (ii) if the shares are preference shares – 90 days.

98. As the Patties shares are not preference shares, Scheme Shareholders are required to hold their shares for at least 45 days during the secondary qualification period.

99. The former section 160APHD of the ITAA 1936 defines the 'secondary qualification period' as follows:

In relation to a taxpayer in relation to shares or an interest in shares, means:

- (a) if the shares are not preference shares – the period beginning on the 45th day before, and ending on the 45th day after, the day on which the shares or interest became ex dividend...

100. The concept of 'ex dividend' is defined by former subsection 160APHE(1) of the ITAA 1936 as follows:

A share in respect of which a dividend is to be paid, or an interest (other than an interest as a beneficiary of a widely held trust) in such a share, becomes ex dividend on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

101. The eligibility for the Special Dividend is determined on 8 September 2016. This is the last day on which acquisition by a person of a Patties share entitled the person to receive the Special Dividend as per former section 160APHE of the ITAA 1936. Accordingly, the ex dividend date for the purposes of former subsection 160APHE(1) of the ITAA 1936 is 9 September 2015.

102. As per the definition in former section 160APHD of the ITAA 1936, the secondary qualification period will begin 45 days before the ex dividend date of 9 September 2016 and end 45 days after that day. This means that the secondary qualification period would ordinarily run from 26 July 2016 to 23 October 2016 (45 days before and 45 days after 9 September 2016).

103. Pursuant to former subsection 160APHO(3) of the ITAA 1936, any days on which an entity had materially diminished risks of loss or opportunities for gain in respect of their Patties shares, or interest in Patties shares, are excluded from counting towards the 45 day holding period requirement. Subsection 160APHO(3) provides:

In calculating the number of days for which the taxpayer continuously held the shares or interest, any days on which the taxpayer has materially diminished risks of loss or opportunities for gain in respect of the shares or interest are to be excluded, but the exclusion of those days is not taken to break the continuity of the period for which the taxpayer held the shares or interest.

104. This would mean that for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, the secondary qualification period would run from 26 July until 22 September 2016, the date that Scheme Shareholders disposed of their shares.

105. Entitlement to participate in the Scheme will be determined on the Scheme Record Date on the basis of being a Scheme Shareholder who is registered in the share register as the holder of the relevant ordinary share at 7:00pm on 15 September 2016. It is considered that once a Scheme Shareholder is identified as a Scheme Shareholder on the Scheme Record Date, that Scheme Shareholder would no longer be considered to hold their shares 'at risk' for the purposes of former Division 1A of former Part IIIAA of the ITAA 1936 as, at that time the Scheme Shareholder is committed to disposing of their Patties shares and receiving the Scheme Consideration. This means that as and from 15 September 2016, Scheme Shareholders no longer held their Patties shares 'at risk'.

106. Accordingly, while the secondary qualification period would relevantly run from 26 July 2016 to 22 September 2016, the period 15 September 2016 to 22 September 2016 would be excluded in determining the period during which the shares were held at risk, as it represents a period of materially diminished risk. As such, a Scheme Shareholder who received the Special Dividend would need to have held their shares at risk for a continuous period of not less than 45 days during the period 26 July 2016 and 14 September 2016 in order to be a 'qualified person' for the purposes of former Division 1A of former Part IIIAA of the ITAA 1936. Pursuant to former paragraph 160APHO(2)(a) of the ITAA 1936, the dates of acquisition and disposal are not included in the relevant 45 day period.

107. Scheme Shareholders could only satisfy the holding period requirement in relation to a Patties share if they acquired that Patties share on or before 31 July 2016 and continued to hold it 'at-risk' until 14 September 2016.

## **Refundable tax offset**

108. Scheme Shareholders who are entitled to a tax offset under subsection 207-20(2), in respect of the franking credit received, will also be subject to the refundable tax offset rules in Division 67, unless specifically excluded under section 67-25.

109. Pursuant to section 67-25, there are a range of taxpayers who are specifically excluded from the operation of the refundable tax offset rules. This range of excluded entities includes:

- non-complying superannuation funds or non-complying approved deposit funds (subsection 67-25(1A))
- a trustee of a trust who is liable to be assessed under section 98 or 99A of the ITAA 1936 (subsection 67-25(1B))
- corporate tax entities, unless the entity is an exempt institution that is eligible for a refund, or a life insurance company that has received distributions on membership interests which were not held by the company on behalf of its shareholders (subsections 67-25(1C) and 67-25(1D)), and
- non-resident entities carrying on business in Australia at or through a permanent establishment (subsection 67-25(1DA)).

110. Accordingly, a holder of Patties shares is subject to the refundable tax offset rules unless they are listed specifically as one of the excluded entities under section 67-25. Generally, corporate tax entities (including companies, corporate limited partnerships, corporate unit trusts, and public trading trusts) will be excluded from the operation of the refundable tax offset rules.

## **Capital Gains Tax (CGT) consequences**

### ***CGT event A1***

111. CGT event A1 happens if there is a change in the ownership of an asset from one entity to another (section 104-10). 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 (subsection 104-10(3)).

112. The acquisition of Patties shares under a court approved scheme of arrangement does not involve a disposal of shares under a contract (paragraph 9 of Taxation Determination TD 2002/4).

113. CGT event A1 happens when a Scheme Shareholder disposed of a Patties share to Bidco pursuant to the Scheme (subsections 104-10(1) and 104-10(2)). The disposal occurred on the Scheme Implementation Date of 22 September 2016 when the Patties share was disposed of by a Scheme Shareholder (paragraph 104-10(3)(b)).

114. 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.

115. A Scheme Shareholder makes a capital gain from CGT event A1 happening if the capital proceeds from the disposal of a Patties share is more than the cost base of the Patties share. A Scheme Shareholder makes a capital loss if those capital proceeds are less than the reduced cost base of the Patties share (subsection 104-10(4)).

### ***Capital proceeds***

116. The capital proceeds received by a Scheme Shareholder from a CGT event is the money and the market value of any property received or entitled to be received (worked out at the time of the event happening) in respect of the event happening (subsection 116-20(1)).

117. The capital proceeds Scheme Shareholders received for the disposal of a Patties share was either the market value of each Class B share received or the amount of Cash Consideration received.

118. The term 'in respect of the event happening' in subsection 116-20(1) requires the relationship between the event and the receipt of the money, or the entitlement to receive the money, to be more than coincidental. An amount is not capital proceeds received or entitled to be received in respect of a CGT event merely because it is received in association with the CGT event.

119. In this case, the Special Dividend was not paid in respect of the disposal of Patties shares under the Scheme. The determination to pay the Special Dividend was at the discretion of Patties' Board. Bidco had no control over Patties' decision to pay it, or its quantum (subject to the \$0.25 ceiling in the Scheme Implementation Deed).

120. The payment of the Special Dividend was funded entirely by Patties' cash reserves and debt facilities with no actual or contingent funding support from Bidco.

121. In these circumstances, it is considered that the Special Dividend does not form part of the capital proceeds which a Scheme Shareholder received in respect of CGT event A1 happening.

***Availability of scrip for scrip roll-over if a capital gain is made***

122. The significant tax consequence is the availability of scrip for scrip roll-over under Subdivision 124-M. It enables a shareholder to disregard a capital gain from a share that is disposed of as part of a corporate takeover or merger if the shareholder receives a replacement share in exchange. It also provides special rules for calculating the cost base and reduced cost base of the replacement share.

123. Subdivision 124-M contains a number of conditions for, and exceptions to, a shareholder being eligible to choose scrip for scrip roll-over. The main requirements that are relevant to the scheme that is the subject of this Ruling are:

- shares are exchanged for shares in another company
- the exchange is in consequence of a single arrangement
- conditions for the roll-over are satisfied
- further conditions, if applicable, are satisfied, and
- exceptions to obtaining scrip for scrip roll-over are not applicable.

***Discount capital gain***

124. If a Scheme Shareholder made a capital gain from the disposal of their Patties share, the Scheme Shareholder may be eligible to treat the capital gain as a discount capital gain provided that all relevant requirements of Division 115 are met.

125. One of those requirements is that the capital gain must result from a CGT event happening to a CGT asset that was acquired by the entity making the capital gain at least 12 months before the CGT event (subsection 115-25(1)).

126. This means that a capital gain made by a Scheme Shareholder when they dispose of their Patties share is a discount capital gain if the shareholder acquired the Patties share at least 12 months before the date of disposal under the Scheme, being the Scheme Implementation Date of 22 September 2016, and the other requirements in Division 115 are satisfied.

***Non-resident Scheme Shareholders***

127. Under subsection 855-10(1), an entity disregards a capital gain or capital loss from a CGT event if they are a non-resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

128. The term 'taxable Australian property' is defined in the table in section 855-15. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property
Item 2	an indirect Australian real property interest not covered by item 5
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

129. Item 2 of the table in section 855-15 defines taxable Australian property to include an indirect Australian real property interest. An indirect Australian real property interest under section 855-25 is an interest held by an entity in another entity if it passes:

- the non-portfolio interest test under section 960-195, and
- the principal asset test in section 855-30.

130. The non-portfolio interest test under section 960-195 is as follows:

An interest held by an entity (the holding entity) in another entity (the test entity) passes the non-portfolio interest test at a time if the sum of the direct participation interests held by the holding entity and its associates in the test entity at that time is 10% or more.

131. A non-resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happens under the Scheme, cannot disregard under subsection 855-10(1) a capital gain or capital loss from CGT event A1 happening if their shares in Patties are indirect Australian real property interests (item 2 of the table in section 855-15).

132. On the basis that there were no non-residents, either alone or together with any associates, who beneficially hold more than 10% of the shares in Patties, none of the Patties shares disposed of as part of the Scheme passes the non-portfolio interest test. Consequently, Patties shares held by non-residents do not constitute indirect Australian real property interests.

133. Since the first condition of an indirect Australian real property interest under section 855-25 is not satisfied, it is not necessary to consider the application of the principal asset test. The Patties shares do not constitute 'taxable Australian property' of non-resident shareholders.



## The anti-avoidance provisions

### Section 177E

134. Section 177E of the ITAA 1936 is an anti-avoidance provision that is designed to prevent tax benefits being obtained as part of a dividend stripping scheme or a scheme with substantially the same effect as a dividend stripping scheme.

135. The term 'dividend stripping' has no precise legal meaning. In its traditional form, a dividend stripping operation occurs when shares in a company with substantial retained profits are acquired by shareholders who pay the existing shareholders a capital sum reflecting the value of the retained profits. The new shareholders then liberate those profits through the payment of a dividend post acquisition. Generally, the new shareholders who derive dividend income from the company would not be liable to tax upon those dividends.

136. Therefore, a scheme by way of, or in the nature of, dividend stripping, or one that has substantially the effect of a scheme by way of, or in the nature of, dividend stripping, would be one that has the effect of delivering a shareholder's entitlement to a dividend in a tax advantaged manner.

137. The retained profits of Patties that are to be distributed to its existing shareholders as the Special Dividend prior to the implementation of the Scheme are not provided in a tax advantaged manner. Consequently section 177E of the ITAA 1936 will not apply.

### Section 177EA

138. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes seeking to obtain a tax advantage in relation to imputation benefits. In essence, it applies to schemes for the disposition of shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares.

139. If section 177EA of the ITAA 1936 applies, the Commissioner may make a determination under subsection 177EA(5) of the ITAA 1936 that either a franking debit arises to the company in respect of each distribution paid to the relevant taxpayer (paragraph 177EA(5)(a) of the ITAA 1936) or, in the alternative, that no imputation benefit arises in respect of a distribution paid to the relevant taxpayer (paragraph 177EA(5)(b) of the ITAA 1936).

140. Subsection 177EA(3) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies if:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:

- (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
- (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the person (the **relevant taxpayer**) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

141. Patties is a corporate tax entity. The sale of the ordinary shares in Patties pursuant to a Scheme of Arrangement is a scheme for the disposition of membership interests. The fully franked Special Dividend is a frankable distribution that was paid to Scheme Shareholders (the relevant taxpayers) as a part of this scheme and who could, therefore, reasonably be expected to receive imputation benefits.

142. In the present case, it is considered that the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme (as provided for in subsection 177EA(17)), it would be concluded that, on the part of Patties, its shareholders or any other relevant party, there is a purpose, more than merely an incidental purpose, of conferring an imputation benefit under the scheme.

143. In arriving at a conclusion, one must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of diverse matters which, taken individually or in conjunction with other matters, listed or not, could indicate the requisite purpose, that is, that the delivery of the imputation benefit is more than an incidental purpose of the scheme.

144. The relevant circumstances are that the disposition of the ordinary shares in Patties was made pursuant to a takeover by PEP by way of Scheme of Arrangement under the Corporations Act voted upon by Scheme Shareholders entitled to vote.

145. Patties' Scheme of Arrangement is a normal commercial transaction under which Patties is being acquired.

146. Scheme Shareholders are a mix of residents and non-residents. The fully franked Special Dividend was paid to all the existing shareholders of Patties in proportion to the number of shares that each shareholder held on the relevant Record Dates and irrespective of their ability to utilise the relevant franking credits. The Special Dividend allowed Scheme Shareholders to share in the accumulated profits of Patties.

147. In considering the manner, form and substance of the scheme, it is considered that the scheme is not being entered into by Patties or Scheme Shareholders for more than an incidental purpose of enabling Scheme Shareholders to obtain imputation benefits. The provision of imputation benefits to Scheme Shareholders remains incidental, in the sense of being subservient to, the purpose of transferring their shares to Bidco.

148. Having regard to the relevant circumstances of the scheme, it cannot be concluded that Patties or Scheme Shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain an imputation benefit.

149. As such, the Commissioner has come to the view that the requisite purpose is not present and accordingly the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit to be received in relation to the dividends.

### **Section 204-30**

150. Section 204-30 applies where a corporate tax entity streams the payment of dividends or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an \*imputation benefit is, or apart from this section would be, received by a \*member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a)), and
- (b) the member would \*derive a \*greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)), and
- (c) the other member of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c)).

151. Relevantly, if section 204-30 applies, the Commissioner has the discretionary powers under subsection 204-30(3) to make a written determination.

152. Subsection 204-30(3) provides:

The Commissioner may make one or more of these determinations:

- (a) that a specified \*franking debit arises in the \*franking account of the entity, for a specified \*distribution or other benefit to a disadvantaged member;

- (b) that a specified \*exempting debit arises in the \*exempting account of the entity, for a specified \*distribution or other benefit to a disadvantaged member;
- (c) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination.

A determination must be in writing.

153. 'Streaming' is not defined for the purposes of section 204-30. However, the Commissioner has understood it to refer to a company 'selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits' (paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002).

154. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The words 'derive a greater benefit from franking credits' are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

155. Under the current arrangement, all Scheme Shareholders received an imputation benefit when the Special Dividend was paid. The imputation benefit for resident shareholders is in the form of a tax offset (paragraph 204-30(6)(a)), and for non-resident shareholders is in the form of not being liable to pay dividend withholding tax (paragraph 204-30(6)(e)). The resident shareholders may derive a greater benefit from franking credits than the non-resident shareholders.

156. However, the Special Dividend was paid equally to all Scheme Shareholders and was fully franked regardless of their tax profiles. Accordingly, it cannot be said that Patties selectively directed the flow of franked distributions to those members who could most benefit from the franking credits.

157. As the conditions in subsection 204-30(1) have not been met, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit received in relation to the Special Dividend.

## Appendix 2 – Detailed contents list

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