

CR 2017/53 - Income tax: Batlow Fruit Company Pty Ltd - converted to a company registered under the Corporations Act 2001



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Class Ruling

Income tax: Batlow Fruit Company Pty Ltd – converted to a company registered under the *Corporations Act 2001*

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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.

Summary – 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:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 45 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- Division 104 of the *Income Tax Assessment Act 1997* (ITAA 1997)

- section 104-25 of the ITAA 1997
- Subdivision 124-A of the ITAA 1997
- Subdivision 124-I of the ITAA 1997
- section 124-520 of the ITAA 1997
- Division 725 of the ITAA 1997
- Division 727 of the ITAA 1997.

All legislative references 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 members of Batlow Fruit Co-operative Ltd (BFC) on the date of conversion **27 June 2017** who:

- held their shares in BFC on capital account, that is, neither as revenue assets (as defined in section 977-50 of the ITAA 1997) nor as trading stock (as defined in subsection 995-1(1) of the ITAA 1997, and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their BFC shares.

(**Note:** Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

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 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

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:

- Rules of the BFC
- BFC 2016 Annual Report
- Implementation and Subscription Deed between BFC and Ausfarm Fresh I Pty Ltd (AFF) dated 15 December 2016
- Constitution of Batlow Fruit Company Pty Ltd (BFCPL)
- schedule of members/shareholders as at 27 June 2017
- Disclosure Statement provided to members
- other information from 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.

Background

9. BFC was established as a co-operative in 1923 and taken to be registered as a co-operative under the *Co-Operatives (Adoption of National Law) Act 2012* and subject to the *Co-operatives National Law* (CNL). The CNL is an appendix to *Co-Operatives (Adoption of National Law) Act 2012*.

10. BFC was a trading co-operative and represented 23 agricultural enterprises and 43 members as at 27 June 2017.

11. Each member held shares in BFC and all shares in BFC were held by members. All members are Australian residents.

12. The major activities of the BFC were storage, packaging and marketing of the members' and its own fruit, supply of netting structures and marketing of external growers' fruit.

13. The BFC group consisted of the following entities with their respective ownership percentage:

- Batlow Brewing Company Pty Ltd (incorporated 7 September 2010) – 38.9%
- ToughNet Pty Ltd (incorporated 7 May 2007) – 100%
- Australian Produce Group Pty Ltd (incorporated 28 September 2006) – 100%
- Batlow Apples Juice Pty Ltd (incorporated 12 February 2015) – 100%
- Batlow Apples Orchards Pty Ltd (incorporated 8 September 2015) – 100%, and
- Batlow Apples Packing Pty Ltd (incorporated 8 September 2015) – 100%.

14. BFC and its wholly owned subsidiaries were not consolidated for income tax purposes.

15. BFC had a financial and tax year ending on 31 January.

16. The capital of BFC consisted of Class 1 and Class 2 shares of nominal value of \$1 each. As at 27 June 2017, there were 43 members holding a total number of shares of 1,206,587 comprising:

- Class 1 shares – 1,149,787, and
- Class 2 shares – 56,800.

Both classes of shares ranked equally.

17. If on the winding up or dissolution of BFC, there remained after the satisfaction of all its debts and liabilities, any property, this would be converted into cash and distributed pro rata amongst the members holding Class 1 shares and Class 2 shares on the basis of their respective shareholdings.

18. Membership of BFC was distinct from shareholding in BFC and, subject to the active membership requirements, there was only one class of membership. An active member of BFC had one vote only in respect of any question or motion arising at a general meeting. A member's right to vote was not attached to, or conferred by, any share held by the member in BFC.

19. BFC was seeking a capital injection to provide growth and sustainability of the business into the future and had been in the market to raise up to \$10 million to invest in the following:

- grow the supply of apples through further capital expenditure on orchards which could include new land, replant new varieties and to increase the hail and bird net coverage
- complete an upgrade of grading technology and cool store systems, and
- repayment of debt and the provision of working capital.

Conversion of BFC to BFCPL

20. The conversion of BFC to BFCPL was implemented in accordance with the Implementation and Subscription Deed between BFC and AFF, an Australian registered proprietary company.

21. The conversion of BFC to BFCPL involved the following steps:

- BFC converting from a co-operative registered under the *Co-operatives (Adoption of National Law) Act 2012* to a proprietary limited company, BFCPL, under Part 5B.1 of the *Corporations Act 2001* (Corporations Act) ('Transfer of Incorporation')
- on completion of the Transfer of Incorporation, each member of BFC received one fully paid share in BFCPL for each fully paid BFC share held, and
- after the ordinary share issue to members of BFC, AFF subscribed for a number of fully paid ordinary shares in the capital of BFCPL which represents 63.3% of the ordinary shares in the capital of BFCPL. AFF paid \$10 million as the aggregate subscription price for these BFCPL shares.

22. The Transfer of Incorporation required a special resolution to be passed.

23. Under the CNL and the *Co-operatives (Adoption of National Law) Act 2012*, members who forfeited their shares within a defined period, could be entitled to be treated as if they were shareholders of BFC. Qualifying former members who wanted to participate in the conversion and who repaid the amount previously received on forfeiture were issued with the number of BFC shares previously held for the purpose of receiving shares in BFCPL.

24. The conversion of BFC to BFCPL occurred on 27 June 2017.

BFCPL

25. BFCPL is registered as a proprietary company under the Corporations Act with 50 shareholders or less.
26. Shares in BFCPL are a single class of ordinary shares. They differ from the Class 1 and Class 2 BFC shares as they do not have any storage rights attached. Instead each grower will deal with BFCPL on a commercial basis with annual contracts in place securing rights to storage.
27. Subject to the BFCPL Constitution and to any rights or restrictions attached to a share or a class of shares, each member has one vote for each share the member holds.
28. Dividends must be paid to members in proportion to their shares, except in relation to shares that have special rights relating to dividends attached to them.
29. If BFCPL is wound up, the members may, subject to any express provision of the Constitution, pass a special resolution allowing the liquidator to do one of the following:
- specify a value for the company's assets, determine how to divide them between different classes of members, and carry out the division, or
 - transfer the whole or any part of the company's assets to trustees for the benefit of members and those liable to contribute to the winding up.

Ruling

Capital Gains Tax

30. CGT event C2 (section 104-25) happened when a member's share in BFC ended on the conversion of BFC to BFCPL.
31. Members of BFC can choose roll-over under section 124-520 for the ending of their shares in BFC.

Value shifting provisions

32. The scheme involving the conversion of BFC to BFCPL is not one to which any of the consequences of Divisions 725 or Division 727 will apply.

Assessable Dividend

33. The issue of BFCPL shares to members upon conversion will not constitute a dividend, as defined in subsection 6(1) of the ITAA 1936.

Anti-avoidance provisions

34. Section 45 of the ITAA 1936 will not apply to treat any amount as a dividend as a consequence of the conversion.

35. Sections 45A and 45B of the ITAA 1936 will not apply to the issue of shares in BFCPL. The Commissioner will not, therefore, make a determination that section 45C of the ITAA 1936 applies to deem the issue of shares to be an unfranked dividend.

Commissioner of Taxation

16 August 2017

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.*

Choosing Subdivision 124-I roll-over for conversion

36. Subdivision 124-I allows a member of a body that is incorporated under a law other than the Corporations Act to choose roll-over for a CGT event that happens when the body converts to a company incorporated under the Corporations Act. The conditions for roll-over are listed in subsection 124-520(1).

37. CGT event C2 in section 104-25 happened when a member's share in BFC ended on the conversion. Members of BFC will be able to choose to obtain roll-over under section 124-520 as the conditions for choosing roll-over will be satisfied.

Conditions for roll-over

38. Paragraph 124-520(1)(a) requires that a member choosing roll-over to be a member of a body that is incorporated under a law described in column 1 of an item of the table in subsection 124-520(1).

39. This requirement is satisfied as BFC was incorporated under the *Co-Operatives (Adoption of National Law) Act 2012*.

40. Paragraph 124-520(1)(b) requires that the body be converted into a company incorporated under a law described in column 2 of the item of the table in subsection 124-520, without creating a new legal entity. Section 601BM(1)(a) of the Corporations Act and section 409 of the CNL provide that incorporation does not create a new legal entity

41. This condition is satisfied as BFC was registered on 27 June 2017 as a company under the Corporations Act.

42. Paragraph 124-520(1)(c) of the ITAA 1997 requires that there is no significant difference between:

- (i) the ownership of the body, and of rights relating to the body held by entities that owned the body, just before the conversion and the ownership of the company just after the conversion, or
- (ii) the mix of ownership of the body, and of rights relating to the body held by entities that owned the body, just before the conversion and the mix of the ownership of the company just after the conversion.

43. Paragraph 124-520(1)(c)(i) is satisfied on the facts of this arrangement. Just before the conversion, the owners of BFC were the members who held shares in BFC. The owners of BFCPL just after the conversion (on 27 June 2017) are the existing members just before the conversion who were issued with shares on conversion.

44. Paragraph 124-520(1)(c)(ii) is satisfied on the facts of this arrangement. It is reasonable to conclude that there is no significant difference between the mix of ownership just before and just after the conversion. The replacement shares in BFCPL were issued to members of BFC in the same number as those held in BFC.

45. The change in voting interests between BFC (one vote per member) and BFCPL (one vote per share) will not cause a significant difference between the mix of ownership of BFC just before the conversion and the mix of ownership of the company just after the conversion for the purposes of subparagraph 124-520(1)(c)(ii).

46. The condition in subsection 124-520(2) requires that a company issues shares to members (and nothing else) in substitution for their interest in the body just before the conversion.

47. This condition is satisfied as BFCPL has issued shares to the members of BFC (and nothing else) in substitution for their interests in BFC held just before the conversion. Each member of BFC has received only shares in BFCPL in substitution for their interests in BFC.

48. Subsection 124-520(2) also requires that, at the time of conversion, either the member is an Australian resident as defined in subsection 6(1) of the ITAA 1936 or the interest in the body for which roll-over is sought is taxable Australian property just before the time of conversion and the shares are taxable Australian property.

49. This requirement is satisfied as all members of BFC are residents of Australia.

Consequences if Subdivision 124-I roll-over is chosen

50. The consequences of a choice being made to apply the roll-over in Subdivision 124-I are set out in Subdivision 124-A:

- for a member that held BFC shares acquired before 20 September 1985, the new shares in BFCPL, issued in exchange are taken to have been acquired before that day, and
- for a member that held BFC shares acquired on or after 20 September 1985, a capital gain or capital loss made on the ending of those shares is disregarded. The first element of the cost base and reduced cost base of the shares in BFCPL will be worked out by apportioning the cost base and reduced cost base of the BFC shares that have ended.

Value shifting consequences

51. There can only be consequences under Division 725 where there is a direct value shift. One of the requirements for there to be a direct value shift as defined in section 725-145 is that there is a decrease in the market value of one or more equity or loan interests in an entity, where the decrease is reasonably attributable to one or more things done under a scheme involving those interests. Based on the arrangement involving the conversion of BFC to a proprietary limited company (being BFCPL) and the subsequent issue of shares to AFF (at market value) there is no decrease in value of any members interests during the scheme period.

52. An indirect value shift as defined in subsection 727-150(3) involves an unequal exchange of economic benefits between two entities, called the losing entity and gaining entity. There are no consequences for any indirect value shift as no entity that provides economic benefits to BFCPL, or receives such economic benefits in return, would, together with BFC or (when converted) BFCPL meet the ultimate controller test or common-ownership nexus test (paragraphs 727-100(c) and 727-110(1)(a), sections 727-105 and 727-355).

Dividend

53. Subsection 6(1) of the ITAA 1936 defines 'dividend' for the purposes of the income tax legislation to include:

- (a) any distribution made by a company to any of its shareholders, whether in money or other property, and
- (b) any amount credited by a company to any of its shareholders as shareholders.

54. The issue of BFCPL shares to members upon conversion did not involve a distribution of money or property of BFCPL to the shareholders as the number and nominal value of the shares issued corresponds to their holding in BFC prior to conversion.

55. No amount is credited to any of the shareholders in their capacity as shareholders.

56. As the conversion did not involve either a distribution of money or property of the company to the shareholders or an amount being credited by the company to any of its shareholders as shareholders, the issue of shares in BFCPL does not constitute a dividend.

Anti-avoidance provisions**Section 45**

57. Section 45 of the ITAA 1936 applies where a company streams the provision of bonus shares and the payment of minimally franked dividends to its shareholders in such a way that bonus shares are received by some shareholders and minimally franked dividends are received by other shareholders. As there was no distribution of dividends, section 45 does not apply.

Section 45A

58. Sections 45A and 45B of the ITAA 1936 are anti-avoidance provisions which, if either applies, allow the Commissioner to make a determination under section 45C of the ITAA 1936 that all or part of a capital benefit is treated as an unfranked dividend.

59. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit than other shareholders from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

60. The 'provision of a capital benefit' is defined in subsection 45A(3) of the ITAA 1936 to include the provision to a shareholder of shares in BFCPL.

61. Although a 'capital benefit', as defined in paragraph 45A(3)(a) of the ITAA 1936, has been provided, the circumstances of the conversion and share issue arrangement indicate that there is no streaming of the provision of shares to some members and the payment of dividends to other members. As the second condition in subsection 45A(1) of the ITAA 1936 is not satisfied, section 45A of the ITAA 1936 does not apply to the issue of shares.

Section 45B

62. Section 45B of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is 'provided with a capital benefit' by a company (paragraph 45B(2)(a) of the ITAA 1936)
- under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, 'obtains a tax benefit' (paragraph 45B(2)(b) of the ITAA 1936), and

- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to 'obtain a tax benefit' (paragraph 45B(2)(c) of the ITAA 1936).

63. In this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 will be met, it is apparent that there is no requisite purpose, in the conversion, by way of capital distribution, of enabling the members to obtain a tax benefit.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(1)
- ITAA 1936 45A(3)
- ITAA 1936 45A(3)(a)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45C
- ITAA 1997
- ITAA 1997 Div 104
- ITAA 1997 104-25
- ITAA 1997 Subdiv 124-A
- ITAA 1997 Subdiv 124-I
- ITAA 1997 124-520
- ITAA 1997 124-520(1)
- ITAA 1997 124-520(1)(a)
- ITAA 1997 124-520(1)(b)
- ITAA 1997 124-520(1)(c)
- ITAA 1997 124-520(1)(c)(i)
- ITAA 1997 124-520(1)(c)(ii)
- ITAA 1997 124-520(2)
- ITAA 1997 Div 725
- ITAA 1997 725-145
- ITAA 1997 Div 727
- ITAA 1997 727-100(c)
- ITAA 1997 727-105
- ITAA 1997 727-110(1)(a)
- ITAA 1997 727-150
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- ITAA 1997 727-355
- Co-operatives (Adoption of National Law) Act 2012
- Corporations Act 2001
- Corporations Act 2001 601BM(1)(a)
- TAA 1953

ATO references

NO: 1-AEN8X7E

ISSN: 2205-5517

ATOlaw topic: Income tax ~~ Assessable income ~~ Dividend income ~~
Deemed income
Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT
events C1 to C3 - end of a CGT asset
Income tax ~~ Capital gains tax ~~ Cost base and
reduced cost base
Income tax ~~ Capital gains tax ~~ Rollovers ~~ Other

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