


CR 2017/72 - Income tax: Grower Shares - conversion of Namoi Cotton Co-operative to a company registered under the Corporations Act 2001 by way of variation

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Class Ruling

Income tax: Grower Shares – conversion of Namoi Cotton Co-operative to a company registered under the *Corporations Act 2001* by way of variation

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📌 This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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 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 108-5 of the ITAA 1997
- section 112-25 of the ITAA 1997

- section 116-20 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 indicated.

Class of entities

3. The class of entities to which this Ruling applies are members of Namoi Cotton Co-operative Ltd (Namoi) who:

- are members of Namoi whose shares in Namoi (Grower Shares) will be converted to ordinary shares in Namoi Cotton Ltd, a company registered under the *Corporations Act 2001* by way of variation
- participate under the arrangement as described in paragraphs 8 to 29
- are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936, and
- are not subject to the taxation of financial arrangements provisions in Division 230 of the ITAA 1997 in relation to gains and losses on their Namoi Grower Shares.

(**Note:** Division 230 will generally not apply to individuals, unless they have made an election for the Division 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 10 October 2017 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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:

- application for Class Ruling from DLA Piper Australia on behalf of Namoi Cotton Co-operative Ltd dated 14 June 2017
- Constitution of Namoi Limited (Draft) dated 15 August 2017
- Rules of Namoi Cotton Co-operative Limited
- Namoi Cotton Restructure Booklet received 17 August 2017
- Grower Share Scheme of Arrangement received 17 August 2017
- Namoi Capital Stock Scheme of Arrangement received 17 August 2017, and
- other correspondence and e-mails from the applicant in relation to the application for the Ruling.

9. Namoi is a co-operative registered under the *Co-operatives (Adoption of National Law) Act 2012* (NSW) (the Co-operatives Act). Namoi is governed by the Rules of Namoi Cotton Co-operative Limited (Namoi Rules).

Members of Namoi

10. Namoi is comprised of its members (Members), most of whom are cotton farmers who actively supply cotton to Namoi.

11. In accordance with the Namoi Rules, a person may only be admitted as a Member of Namoi if the person is an 'Active Member' of the co-operative. Each Active Member must hold at least 800 Grower Shares, produce cotton from a minimum of 40 hectares of land and conduct a minimum of 20% of the Member's total cotton business with the co-operative. Active Members were entitled to 1 vote per Member.

12. The shares of Namoi are all of one class called Grower Shares. They have a nominal value of \$0.01, and were issued for a fixed amount of \$2.70. The Grower Shares do not provide an entitlement to dividends.

13. On a winding up of Namoi, the holders of Grower Shares are entitled to capital distribution up to \$2.70 per share, but are not entitled to participate in any further distribution of surplus assets.

14. Namoi has on issue 165,600 unquoted Grower Shares, held by 207 Members (Grower Members).

15. No single Member (together with its associates) can hold more than 20% of the total Grower Shares in Namoi. Prior to the Transaction, no single Member holds greater than 1% of the total Grower Shares in Namoi.

Namoi Capital Stock

16. In addition to its Grower Shares, Namoi has on issue 109,843,279 Namoi Capital Stock (also known as Co-operative Capital Units, or CCUs) which are held by 1,532 holders (CCU Holders). As at 1 March 2017, 141,000 CCUs were issued to employees pursuant to the Namoi Cotton Employee Incentive Share Plan.

17. No single entity (together with its associates) can hold more than 20% of the total CCUs in Namoi. Prior to the Transaction, no single CCU Holder holds greater than 15% of the total CCUs in Namoi. As at 12 June 2017, 106 CCU Holders were non-residents for Australian tax purposes. All non-residents other than one (which holds 13%), hold less than 10% of the interests in the CCUs in Namoi.

18. Pursuant to section 345 of the Co-operatives Act, the CCUs are interests issued by Namoi conferring an interest in the capital (but not the share capital) of Namoi. Subsection 345(2) of the Co-operatives Act specifically provides that a CCU is personal property.

19. The CCUs are all of one class, with a nominal value of \$0.01 each. The CCU Holders are entitled to all of the dividends payable by Namoi.

20. On a winding up of Namoi, the CCU Holders are entitled to all of the surplus assets and profits of Namoi after the fixed claims of the Members are satisfied.

21. The CCUs are able to be freely transferred via the Australian Securities Exchange (ASX).

22. The CCU Holders have the right to nominate a minimum of 2 (and a maximum of 3) Directors to the Board of Namoi, subject to the size and composition of the Board. The CCU Holders have the right to attend the Members' general meetings but do not have the right to vote at the general meetings.

23. None of the Members or CCU Holders, individually or together with associates in fact control Namoi at any time.

Transaction

24. The Board of Directors of Namoi propose to convert Namoi from a co-operative registered under the Co-operatives Act to a public company registered under the *Corporations Act 2001* (the Corporations Act) which will have a single class of ordinary shares (Transaction). The ordinary shares will be subsequently listed on the ASX.

25. The reasons for the Transaction include:

- the alignment of ownership between the Members and CCU Holders
- to ensure a clear ownership structure, and
- providing Namoi with greater access to capital.

26. The Transaction involves the following steps:

Step 1: The rights attaching to the CCUs will be varied (with the approval of Members and CCU Holders) to enable the CCUs to be converted, at each CCU Holder's election, into ordinary shares after Namoi has converted from a co-operative to a company registered under the Corporations Act. The timing of the election for the conversion would be on or before the Effective Date of the scheme.

Step 2(a): At the Effective Time, Namoi converting from a co-operative registered under the Co-operatives Act to a public company registered under the Corporations Act limited by shares.

Step 2(b): At the Effective Time, the rights attaching to the Grower Shares will be varied such that the Grower Shares will become ordinary shares of Namoi on a 1:1 basis.

Step 2(c): At the Effective Time, CCUs will be varied and be redesignated as (and bear the title of) Residual Capital Stock (RCS).

The RCS will constitute an interest in the capital (but not the share capital) of Namoi Limited and will have the following characteristics:

- the RCS will not be transferable

- the RCS will not be listed on the ASX
- each RCS will have no right to be paid distributions or dividends
- each RCS will have no voting rights or rights to attend or participate in general meetings of Namoi Limited, except on a variation of rights of the RCS, and
- each holder of RCS will have a right to repayment of \$0.01 on a winding up with the RCS ranked on an equal basis with the ordinary shares.

Step 3 (a): Immediately after the Effective Time, the ordinary shares will be reconstituted to a different number of ordinary shares via a share split on an 800:158,504 basis (that is, 1:198.13).

Step 3(b): Immediately after the Effective Time, for the CCU Holders who elect for the conversion, each RCS held will be converted to ordinary shares on a 1-for-1 basis by way of variation. It is intended that all remaining RCS will be redeemed within 12 months after the record date of the Transaction.

27. Assuming full conversion of the CCUs into ordinary shares, 23% of the total ordinary shares under the Transaction will be allocated to Members and the remaining 77% of the shares in Namoi Limited will be held by the CCU Holders.

28. Immediately after the Transaction, none of the ordinary shareholders, individually or together with associates will have more than a 20% shareholding in or control Namoi Ltd at any time.

29. The Effective Date is 10 October 2017.

Ruling

Variation of Grower Shares

CGT event H2

30. CGT event H2 will happen to the Members pursuant to subsection 104-155(1) when the Grower Shares are converted to ordinary shares in Namoi Limited by way of variation. However, no capital gain will be triggered as a result of the event as no capital proceeds will be received by the Members. The Members will make a capital loss to the extent of any incidental costs incurred in respect of the conversion by way of variation.

31. The acquisition time of the ordinary shares will be the acquisition time of the Grower Shares for CGT purposes.

32. The cost base or reduced cost base of each ordinary share will be the cost base or reduced cost base of each Grower Share (that is, \$2.70).

Value shifting provisions

33. Neither Division 725 nor Division 727 will apply as a result of the Transaction.

Assessable dividend

34. The Transaction will not result in an assessable dividend, as defined in subsection 6(1) of the ITAA 1936, for the Members.

Anti-avoidance provisions

35. Section 45A and 45B of the ITAA 1936 will not apply to the Transaction. The Commissioner will not, therefore, make a determination that section 45C of the ITAA 1936 applies to deem the variation of Grower Shares into ordinary shares to be an unfranked dividend.

Capital gains tax – share split

36. The splitting of the ordinary shares into a greater number of ordinary shares will not result in a CGT event in Division 104 happening (subsections 112-25(1) and (2)).

37. Each new ordinary share will have:

- the same acquisition date as the original ordinary shares to which they relate, and
- a cost base and reduced cost base that is based on a reasonable apportionment of the cost base and reduced cost base of the original share to which they relate (subsection 112-25(3)).

Commissioner of Taxation

11 October 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.*

Variation of Grower Shares

CGT event C2

38. CGT event C2 happens if the ownership of an intangible CGT asset ends by the asset being, amongst other things, redeemed or cancelled (subsection 104-25(1)). The time of the event is when a contract is entered into which results in the asset ending or, if there is no contract, when the asset ends (subsection 104-25(2)).

39. Each Grower Share is comprised of a bundle of rights which are not separate pieces of property capable of being divided out and held separately. Accordingly, for CGT purposes, the rights attaching to each Grower Share do not constitute individual assets as defined in section 108-5, but rather combine to make up the ultimate asset, being the share (refer to Taxation Ruling TR 94/30 *Income tax: capital gains tax implications of varying rights attaching to shares*).

40. Each Grower Share representing a bundle of rights and obligations will be varied such that they can be converted into ordinary shares in Namoi Limited, a continuing body corporate of Namoi. The conversion of the Grower Shares will not constitute a redemption or cancellation of the Grower Shares for the purposes of CGT event C2. Accordingly, paragraph 104-25(1)(a) will not be satisfied, a result that is consistent with Taxation Ruling TR 94/30.

CGT event H2

41. CGT event H2 happens if an act, transaction or event occurs in relation to a CGT asset and the act, transaction or event does not result in an adjustment being made to the asset’s cost base or reduced cost base (section 104-155). The conversion into ordinary shares by way of variation is an act, transaction or event in relation to the Grower Shares. Therefore, the conversion by way of variation will result in CGT event H2 happening in respect of the Grower Shares.

42. A capital gain is made if the capital proceeds from the event are more than the incidental costs incurred in relation to it; a capital loss is made if the capital proceeds are less than the incidental costs (subsection 104-155(3)).

43. Capital proceeds are the money or other consideration received, or entitled to be received, because of the act, transaction or event (subsection 116-20(2)).

44. Grower Members will not receive or be entitled to receive any capital proceeds in respect of the conversion by way of variation. Therefore, although CGT event H2 will happen in respect of the Grower Shares, the Grower Members will not make a capital gain. However, they will make a capital loss to the extent of any incidental costs incurred in respect of the conversion by way of variation.

Value shifting consequences

45. There can be capital gains tax and income tax consequences where there is a direct value shift as defined in section 725-145 or an indirect value shift as defined in section 727-150. However, there are only consequences where threshold control tests are satisfied.

46. The direct value shifting rules in Division 725 do not apply unless there is an entity that controls (for value shifting purposes) the target entity at some time during a scheme period (paragraph 725-50(b) and section 725-55).

47. The indirect value shifting rules in Division 727 do not apply unless the entities between which value is shifted (the losing entity and the gaining entity) satisfy an ultimate controller test or a common ownership nexus test (paragraph 727-100(c) and sections 727-105 and 727-110).

48. There will be no consequences for any direct value shift as there is no entity that controls (for value shifting purposes) Namoi or (when converted) Namoi Limited at any time from when the scheme is entered into until when it is carried out (paragraph 725-50(b) and section 725-55).

49. There will be no consequences for any indirect value shift as the ultimate controller test or common ownership nexus test is not satisfied (paragraph 727-100(c), subsection 727-110(1) and section 727-105).

Assessable dividend

50. 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.

51. The conversion of Grower Shares to ordinary shares by way of variation will not involve a distribution of money or property to the shareholders.

52. No amount will be credited to any of the shareholders in their capacity as shareholders.

53. As the conversion by way of variation will 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, it will not constitute a dividend.

Anti-avoidance provisions

Section 45A

54. 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.

55. 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).

56. The 'provision of capital benefit' is defined in subsection 45A(3) of the ITAA 1936 to include something that is done in relation to a share that has the effect of increasing the value of a share held by the shareholder. The circumstances of the conversion arrangement indicate there is no streaming of capital benefits to some and the payment of dividends to others. As subsection 45A(1) of the ITAA 1936 is not satisfied, section 45A of the ITAA 1936 will not apply.

57. As section 45A of the ITAA 1936 will not apply the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to deem the conversion of Grower Shares by way of variation to be an unfranked dividend.

Section 45B

58. 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).

59. In this case, it is apparent that there is no requisite purpose, in the conversion of Grower Shares by way of variation to ordinary shares, of enabling the Members to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies.

Capital gains tax – share split

60. Section 112-25 applies where a CGT asset is split into 2 or more assets and the beneficial owner of the original asset and of each new asset is the same (subsection 112-25(1)).

61. Where section 112-25 applies, the splitting is not a CGT event (subsection 112-25(2)).

62. Under the Transaction, each parcel of 800 ordinary shares held by Members will be split into 158,504 ordinary shares. The beneficial owners of the original ordinary shares will be the beneficial owners of the new ordinary shares. Accordingly, this splitting of shares will satisfy the requirements in subsection 112-25(1) (that is, each original share will be split into 2 or more new ordinary shares in the hands of the holders). Thus, the splitting of shares will not be a CGT event pursuant to subsection 112-25(2).

63. As no CGT event happens, there will be no change in the acquisition date of the shares. That is, the acquisition date of each new ordinary share will be the same as the acquisition date of the original ordinary share to which it relates.

64. The cost base and reduced cost base of each new ordinary share will be worked out by apportioning in a reasonable way each element of the cost base and reduced cost base of the original ordinary share to each new ordinary share (subsection 112-25(3)).

65. In this case, the Commissioner is satisfied that a reasonable apportionment will be obtained by dividing the cost base and reduced cost base of the original 800 ordinary shares by 158,504.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 94/30; TR 2006/10

Legislative references:

- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(1)
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)
 - 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 104-25(1)
 - ITAA 1997 104-25(1)(a)
 - ITAA 1997 104-25(2)
 - ITAA 1997 104-155
 - ITAA 1997 104-155(1)
 - ITAA 1997 104-155(3)
 - ITAA 1997 108-5
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 - ITAA 1997 116-20(2)
 - ITAA 1997 Div 230
 - ITAA 1997 Div 725
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 - ITAA 1997 725-55
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 - ITAA 1997 Div 727
 - ITAA 1997 727-100
 - ITAA 1997 727-100(c)
 - ITAA 1997 727-105
 - ITAA 1997 727-110
 - ITAA 1997 727-110(1)
 - ITAA 1997 727-150
 - Corporations Act 2001
 - Corporations Act 2001 601BM(1)(a)
 - Co-operatives (Adoption of National Law) Act 2012 (NSW)
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 - Co-operatives (Adoption of National Law) Act 2012 (NSW) 345
 - Co-operatives (Adoption of National Law) Act 2012 (NSW) 345(2)
 - Co-operatives (Adoption of National Law) Act 2012 (NSW) 409
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ATO references

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