

CR 2025/2 - DBG Global Enterprises Pty Ltd - customer equity scheme

 This cover sheet is provided for information only. It does not form part of *CR 2025/2 - DBG Global Enterprises Pty Ltd - customer equity scheme*

 This document has changed over time. This is a consolidated version of the ruling which was published on *19 August 2026*



Status: **legally binding**

Class Ruling

DBG Global Enterprises Pty Ltd – customer equity scheme

❶ Relying on this Ruling

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

(Note: this is a consolidated version of this document. Refer to the ATO Legal database (ato.gov.au/law) to check its currency and to view the details of all changes.)

Table of Contents	Paragraph
What this Ruling is about	1
Who this Ruling applies to	5
When this Ruling applies	7
Ruling	8
Scheme	24
Appendix – Explanation	74

What this Ruling is about

1. This Ruling sets out the income tax consequences for participants in the Customer Equity Scheme (CES) of DBG Global Enterprises Pty Ltd (DBG) described in this Ruling.
2. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.
3. Unless otherwise defined, capitalised terms in this Ruling take their meaning from the draft Redeemable Preference Shares Terms of Issue (RPS Terms) and draft Sponsorship Deed listed in paragraph 25 of this Ruling.
4. Details of this scheme are set out in paragraphs 24 to 73 of this Ruling.

Note: By issuing this Ruling, the ATO is not endorsing this product. Potential participants must form their own view about the product.

Who this Ruling applies to

5. This Ruling applies to you if you:
 - acquire redeemable preference shares (RPS) issued in a company to be established as a wholly owned subsidiary of DBG (referred to in this Ruling as RPS Co), under the CES, and
 - are a tax resident of Australia for the purposes of subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936).

Status: **legally binding**

6. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 24 to 73 of this Ruling.

Note: Division 230 will not apply to individuals unless they have made an election for it to apply.

When this Ruling applies

7. This Ruling applies from 1 July 2026 to 30 June 2031.

Ruling

Redeemable preference shares are equity interests

8. The RPS are equity interests for the purposes of Division 974.

Redeemable preference shares are not traditional securities or qualifying securities

9. RPS are not traditional securities or qualifying securities. An RPS is not a traditional security as defined in subsection 26BB(1) of the ITAA 1936 or a qualifying security as defined in subsection 159GP(1) of the ITAA 1936.

Redeemable preference shares are not assessable income at the time they are provided to a Head Office

10. An amount will not be included in the assessable income of a Head Office at the time, and as a result of, the issue of RPS under section 6-5 or section 15-15 or under section 21A of the ITAA 1936.

Tax implications for a Head Office on the transfer of redeemable preference shares from a Head Office to a Group Pharmacy

11. The transfer of RPS from a Head Office to a Group Pharmacy will not give rise to assessable income for the Head Office under section 6-5.

12. A transfer of RPS from a Head Office to a Group Pharmacy will not give rise to assessable income under section 6-10 if the parties are dealing with each other at arm's length in relation to the transfer.

13. However, a transfer of RPS from a Head Office to a Group Pharmacy may give rise to assessable income under section 6-10 for the Head Office where the parties are not dealing with each other at arm's length in relation to the transfer. In this case, market value consideration will be deemed to be received by the Head Office. The market value of the RPS may be higher than the Issue Price where a Redemption Event has been announced or is imminent. Accordingly, a Head Office may make a capital gain on the transfer if the Head Office and Group Pharmacy are not dealing at arm's length.

Status: **legally binding**

Tax implications for Group Pharmacies on the acquisition of redeemable preference shares

14. An amount will not be included in the assessable income of a Group Pharmacy at the time of, and as a result of, the transfer of RPS from a Head Office to a Group Pharmacy under sections 6-5 or 15-15 or under section 21A of the ITAA 1936.

15. A Group Pharmacy's cost base will be \$0.01 under section 110-25 where it is dealing at arm's length with the Head Office in relation to the transfer.

16. If a Head Office and Group Pharmacy are not dealing at arm's length in relation to the transfer, the Group Pharmacy's cost base for capital gains tax purposes would be equal to the market value of the RPS at the time of acquisition, pursuant to section 112-20.

Tax implications for a Group Pharmacy or other holder (apart from a Head Office) on a permitted transfer of redeemable preference shares prior to Redemption under clause 8 of the RPS Terms

17. The transfer of RPS by a holder (other than a Head Office) as permitted under clause 8 of the RPS Terms will result in the derivation of assessable income for the transferor under section 6-5 where the disposal consideration exceeds the price paid for the RPS.

18. A holder of RPS (other than a Head Office) will make a capital gain on the permitted transfer of RPS under section 104-10 where the consideration for the transfer exceeds the cost base of the RPS, or where the market value of the RPS exceeds the cost base of the RPS and the parties are not dealing at arm's length. The capital gain will be reduced under section 118-20 to the extent any amount is included in the RPS holder's assessable income under section 6-5 in relation to the transfer.

19. The first element of the transferee's cost base will be the money paid or required to be paid to acquire the RPS under subsection 110-25(1). If the parties are not dealing at arm's length in relation to the transfer, the transferee's cost base for capital gains tax purposes would be equal to the market value of the RPS at the time of acquisition, pursuant to section 112-20.

Tax implications for an RPS holder on Redemption

20. An RPS holder's assessable income will include the net gain made on Redemption in the income year in which the Redemption happens (including when a Conversion happens) under section 6-5.

21. The net gain will be the Redemption Amount (either paid in cash or applied to subscribe for shares in DBG) reduced by the price paid by the RPS holder to acquire the RPS (on issue or pursuant to a later permitted transfer under clause 8 of the RPS Terms).

22. A CGT event (CGT event A1 or C2) will happen for an RPS holder as a result of a Redemption. However, under section 118-20, any capital gain made as a result of the Redemption will be reduced by the amount included in the holder's assessable income under section 6-5.

Status: **legally binding**

Direct value shifting rules do not apply

23. The direct value shifting provisions in Division 725 will not apply to a holder of RPS as a result of the:

- issue of RPS to Head Offices
- issue of ordinary shares by RPS Co to DBG to facilitate a Redemption, or
- Redemption of the RPS by RPS Co.

Scheme

24. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

25. The following documents are referred to in this description of the scheme and elsewhere in the Ruling:

- Draft RPS Terms of Issue
- Draft Sponsorship Deed
- Draft Prospectus.

Background

26. DBG is a company incorporated in Australia and a tax resident under subsection 6(1) of the ITAA 1936. DBG is not an authorised deposit-taking institution.

27. DBG, and its subsidiaries (DBG Group), are a diversified health, wellness and beauty group selling products and services to wholesalers, who on-sell them to independent pharmacies and pharmacy groups.

28. Pharmacy groups consist of a head office entity, which may be a company or trust (Head Office) and members that are entities carrying on the business of supply to the public or a section of the public in Australia of pharmaceutical and non-pharmaceutical goods or services (Group Pharmacies).

29. The Head Office acts on behalf of a 'buying group' or 'banner group' of Group Pharmacies operating either independently, or under a common banner or brand (buying group).

30. In general terms, the Head Office provides a number of benefits to Group Pharmacies and seeks to attract independent pharmacies to join the group operated by that Head Office.

31. The key benefits offered by a Head Office to pharmacies that join the group generally include:

- branding and name recognition (where bannered)
- taking over some of the administrative and back office functions
- additional training to staff
- providing marketing and advertising materials and support
- coordinating promotional activities

Status: **legally binding**

- accessing locums as required
- ability to negotiate more favourable deals with product providers.

32. For a Group Pharmacy, the key financial purchasing benefit from having a relationship with a buying group arises from the ability of the Head Office to negotiate a discount with the wholesalers, distributors or manufacturers (suppliers), the benefit of which is shared between the Head Office and the members of the buying group. The suppliers benefit by securing access to the entire membership of the buying group by dealing with a single intermediary.

33. The Head Office derives fees from Group Pharmacies. This is generally a monthly fixed fee to cover items such as administration, salaries, issue of catalogues, training and branding based on the particular services provided to the Group Pharmacy.

34. In this Ruling, the Head Office or the Group Pharmacy is referred to as the Customer.

Customer Equity Scheme

35. DBG is proposing to implement and operate a customer loyalty program in the form of the CES for the following main purposes:

- provide an incentive for the Customers to remain loyal customers of DBG and for Group Pharmacies to increase their purchase of health and wellness products and services from wholesalers that source their products from DBG
- recognise the contribution of Customers to the long-term performance and success of DBG
- provide Customers with the opportunity to share in the growth and success of DBG, particularly as a result of a Liquidity Event.

36. DBG will establish a wholly owned special purpose public company limited by shares, referred to in this Ruling as RPS Co. DBG will own all of the ordinary shares issued in RPS Co, and therefore, will control RPS Co.

37. RPS Co will deal at arm's length with Head Offices in relation to the CES.

38. RPS Co's activities will be confined to the issue of RPS to the Head Offices and their subsequent redemption. This being the case, RPS Co will not carry on any business or accumulate any assets.

39. Under the proposed CES, RPS Co will invite Head Offices for at least one pharmacy group to subscribe for a specified number of RPS. Head Offices will receive an allocation of RPS based on their, and their Group Pharmacies, prior support of DBG.

40. The Head Office will be permitted to transfer some or all of the RPS to its Group Pharmacies at its discretion, subject to the terms and conditions determined by DBG.

41. The RPS issued under the CES at the discretion of DBG may, among other things, be converted into fully paid ordinary shares in DBG or an entity to be listed as part of an initial public offering (IPO Entity) on the happening of a Liquidity Event, or at a specified time.

42. Once the RPS are issued, Customers will be required to satisfy certain performance hurdles to retain their RPS in the form of ongoing minimum levels of purchases of certain products and services of DBG over a defined period.

Status: **legally binding**

Rationale for issuing redeemable preference shares in RPS Co instead of shares in DBG Global Enterprises Pty Ltd

43. The commercial and financial reasons for issuing RPS in RPS Co rather than issuing shares in DBG are as follows:

- Issuing options over DBG shares, or other interests which provide returns based on performance, would be characterised as ‘derivatives’ for corporate law purposes, and give rise to regulatory issues.
- Although RPS Co will offer the RPS under a prospectus lodged with the Australian Securities and Investment Commission and prepare and make publicly available a target market determination for the RPS, the DBG Group will neither be required to obtain an Australian financial services licence nor disclose extensive financial information about the DBG Group.
- The proposed structure of the CES will satisfy the objectives of DBG within the framework of a relatively low cost scheme. Further, financial reporting requirements and continuous disclosure obligations will be limited because RPS Co will have no material operations or business.

Rationale for dealing with the Head Offices

44. DBG decided to deal directly with the Head Offices to implement the CES, rather than directly with the Group Pharmacies, because there will be less overall administration costs and the interests of the DBG Group will be aligned with both the Head Offices and the Group Pharmacies.

45. The CES is intended to facilitate the commercial aims of the Head Office entities in the following ways:

- The ability of the Head Office to allocate the RPS will provide a method of incentivising the pharmacies to continue supporting the Head Office, which may in turn, increase the value of any RPS retained by the Head Office.
- The creation of a ‘growth pool’ of RPS to be allocated to the Head Office entities to allow such entities to provide additional incentives to attract new members to their group through the issue of RPS under the CES.

46. The availability of an equity reward is expected to be unique to the DBG Group offering, which is envisaged to attract pharmacies to Head Office entities so that they may also participate in the scheme. The CES is intended to benefit the DBG Group, the Head Office and the Group Pharmacies.

Significant features of the Customer Equity Scheme

47. The terms of the CES will be constituted under the following documents¹:

- The RPS Terms, which will govern the terms of issue of the RPS under the constitution of RPS Co to the Head Office and also the transfer of RPS from the Head Office to any Group Pharmacy and other permitted transfers. The RPS Terms will apply equally to a Group Pharmacy (or other permitted transferee).

¹ At the time of preparing this Ruling, these documents were in draft form.

Status: **legally binding**

- The Sponsorship Deed between RPS Co and DBG, which provides for DBG to fund (including by way of subscription for ordinary shares in RPS Co) RPS Co's discharge of its obligations under the RPS Terms.
- The RPS Co Prospectus and related target market determination. The target market determination will set out the target market for RPS, distribution conditions and information relating to review and monitoring.

48. RPS Co will only issue RPS to the Head Office of a pharmacy group if one or more members of such group have purchased pharmaceutical or other products from a wholesaler or other entity supplied by the DBG Group.

49. The issue price to be paid by a Head Office for each RPS subscribed for is \$0.01 (Issue Price).

50. RPS Co will prescribe performance hurdle requirements for Customers to meet in the Prospectus or in an offer of RPS to the Head Office accompanied by the Prospectus.

51. The RPS will be a separate class of shares in RPS Co from the ordinary shares held by DBG.

52. An RPS does not entitle its holder to vote, whether at a general meeting of RPS Co or otherwise, other than on a proposal that affects the rights attached to the RPS.

53. An RPS does not entitle its holder to any right to dividends or other distributions (including distributions of capital) other than on the redemption of the RPS.

54. An RPS confers on its holder in a winding up of RPS Co and in priority to any other class of shares, the right to the lesser of the:

- RPS Value of the RPS, and
- Issue Price of the RPS.

55. RPS cannot be transferred other than as permitted under clause 8 of the RPS Terms (subject to the right of RPS Co to refuse to register a transfer where it would result in negative outcomes for RPS Co, DBG, the Head Offices and the other holders of RPS):

- All or any RPS issued to the Head Office by RPS Co may be transferred to a Group Pharmacy that is a member of the Head Office pharmacy group; there is no prescribed number nor any limit on the number of RPS that may be transferred by the Head Office to a Group Pharmacy. Such transfers must only occur for an amount equal to the Issue Price that is, \$0.01 per RPS). Once transferred, the RPS will be held by the Group Pharmacy on the same terms and conditions as if they were held by the Head Office.
- A holder of an RPS not being a Head Office may transfer RPS to
 - the Key Person in respect of the holder (the person who is the Customer associated with that holder)
 - a shareholder, unitholder or beneficiary of a holder
 - a relative (as defined in the *Corporations Act 2001*) of a shareholder, unitholder or beneficiary of a holder
 - a body corporate controlled by the holder, the Key Person in respect of the holder or a relative of a shareholder, unitholder or beneficiary of the holder

Status: **legally binding**

- a body corporate acting as trustee of a family trust where the holder, holder's relative or the Key Person are the only beneficiaries of the trust.

If a person ceases to satisfy these criteria, they must immediately transfer all RPS back to the Key Person or other eligible holder in respect of the Key Person.

- The trustees of a family trust may, on any change of trustee or trustees, transfer all of the RPS held by them in that capacity to the new trustees of that family trust.
- A holder of RPS that is a body corporate and not a Head Office may transfer all or any of its RPS to another member of its wholly owned group (provided that the holder must procure that, if that other member ceases to be in such wholly owned group, it will immediately transfer the previously transferred RPS either to the original holder or to another member of the original holder's wholly owned group).
- A holder of RPS which is or the Key Person in respect of which is a Customer and a member of a Pharmacy Group may transfer all or some of its RPS to or to an entity the Key Person in respect of which is, a Customer and a member of the same Pharmacy Group.
- A holder of RPS must transfer the RPS to any person as directed by RPS Co in accordance with a redemption of the RPS.

56. An RPS is redeemable by RPS Co in its sole and absolute discretion. The holder of an RPS has no right to request or require the redemption of an RPS.

57. An RPS may be redeemed by RPS Co on the occurrence of one of the following events (Redemption Events):

- a Liquidity Event, which is a Business Sale, an initial public offering (IPO), a Change of Control or such other events determined by RPS Co (as defined in the RPS Terms)
- certain redemption dates where a Liquidity Event has not occurred by these dates (Redemption Dates)
- a holder of RPS or a Key Person in relation to the holder of the RPS becoming or likely to become (through the giving of notice, the elapse of time or otherwise) a Good Leaver or Bad Leaver or the holder of RPS is or is likely to become (through the giving of notice, the elapse of time or otherwise) a Prohibited Transferee.

58. When RPS Co decides to redeem the RPS on the occurrence of a Redemption Event under the RPS Terms, this is referred to in this Ruling as Redemption.

59. The Redemption Dates are determined by the Board of DBG in its sole and absolute discretion and notified to RPS Co. This effectively means that the RPS can exist and not be redeemed for an indefinite period of time. RPS Co may postpone the final redemption date for a variety of reasons including:

- a material and unexpected downturn in DBG's performance or earnings
- the DBG Group enters into a transaction that is likely to lead to a significant change in the nature or scale of its activities

Status: **legally binding**

- the DBG Group or any of its member companies undertakes a material acquisition or disposal
- the entry into, variation or termination of a material agreement to which a DBG Group Member is a party
- the DBG Board become aware that a DBG Group Member has or may likely become the subject of a significant regulatory investigation
- the appointment of a liquidator, administrator or receiver to any material DBG Group Member, and
- the occurrence of an event of default or other event entitling any financier to DBG to terminate or accelerate repayment under a material DBG Group financing facility.

60. RPS Co will have unfettered discretion to determine the type of Redemption (including to transfer as directed, buy-back, reduce capital, cancel or any combination of any of the foregoing).

61. If a Key Person in relation to a holder of RPS is, becomes, or is likely to become, a Bad Leaver or a Prohibited Transferee, RPS Co in its sole and absolute discretion may at any time elect to redeem all RPS of that holder for an amount equal to the aggregate of the Issue Prices of those RPS then held by the holder (applicable Redemption Amount):

- A Bad Leaver is a holder of RPS or a Key Person
 - who is in breach the RPS Terms
 - who commits fraud or a dishonest act
 - who or whose relative or wholly owned group ceases to be a Customer where the cessation occurs because of serious misconduct, a material breach of the terms of any contract or supply agreement entered into by a Group Company and the Key Person, or gross negligence of a Key Person (as determined by RPS Co acting reasonably)
 - who becomes insolvent, or
 - who continues to fail to comply with Prescribed Customer Requirements of the relevant Group Pharmacy for at least 3 consecutive calendar months after notice is given by RPS Co to the Customer of that failure to comply.
- A Prohibited Transferee is a transferee who is or is likely to become an entity who acquires a significant amount of its products for on-sale from a wholesaler or other entity supplied by a competitor of the DBG Group.

62. A Good Leaver is a leaver who is not a Bad Leaver.

63. Where the RPS are redeemed as a result of a Liquidity Event, a holder becoming or likely to become a Good Leaver or on one of the Redemption Dates, the RPS will be redeemed by RPS Co at the applicable Redemption Amount, which is the aggregate RPS Value of all of those RPS rounded down to the nearest whole dollar.

64. The RPS Value is defined to mean, in relation to an RPS and a Redemption Event the amount (including any fractional component) calculated in accordance with the following factor:

$$\text{FMV at Redemption Event}) \div (\text{No. of Sponsor Shares} + \text{Total Converted RPS})$$

Status: **legally binding**

Where:

- FMV at Redemption Event means the most recent FMV as calculated by DBG (acting reasonably) and notified to RPS Co prior to the Redemption Event;
- No. of Sponsor Shares means the total number of shares in DBG on issue immediately before the Redemption Event; and
- Total Converted RPS means the total number of shares in DBG into which all RPS on issue immediately before the Redemption Event would Convert in accordance with the Sponsorship Deed as at the Redemption Event were the Redemption Event to apply to all such RPS, rounded down to the nearest whole DBG Share.
- FMV means:
 - in the case of a Liquidity Event, the value of the DBG Group or the Business implied by the Liquidity Event (as applicable to the Liquidity Event and as calculated by or on behalf of DBG (acting reasonably) and notified to RPS Co in accordance with the Sponsorship Deed); and
 - in the case of any other Redemption Event, the net asset value of the DBG Group calculated by or on behalf of DBG on a consolidated basis as the estimated fair market value of the Business plus any other assets and liabilities of the DBG Group including net working capital and internally generated goodwill, but excluding any regulatory capital as determined by DBG (acting reasonably).

65. Under the Sponsorship Deed:

- in the case of a Liquidity Event, DBG will determine the FMV based on the values of the Business or the DBG Group and the DBG shares respectively implied by the Liquidity Event
- in the case of another Redemption Event, DBG must appoint an independent chartered accountant, an investment bank or other professional valuer of good standing to determine FMV and the Fair Value of the DBG Shares, in which case the FMV and the valuation of the DBG Shares is the Fair Value as certified by the Independent Valuer.

66. On Redemption, as a result of the occurrence or proposed occurrence of a Liquidity Event comprising an IPO or Business Sale, RPS Co may in its sole and absolute discretion convert the RPS (Conversion). This means, RPS Co will apply the applicable Redemption Amount on behalf of each holder of RPS to the acquisition by that holder of fully paid ordinary shares in DBG or an IPO Entity in accordance with the Sponsorship Deed.

67. Holders of RPS do not obtain enforceable rights against DBG. Rather, their rights are limited to those set out against RPS Co under the RPS Terms. RPS Co is only bound to redeem the RPS if so directed by DBG under the Sponsorship Deed.

68. DBG is required to fund the Redemption:

- In the case of a share cancellation or share buy-back, DBG must pay to RPS Co an amount equal to the amount payable by RPS Co for the Redemption by way of application money to subscribe for ordinary shares in RPS Co.

Status: **legally binding**

- If RPS are to be redeemed by way of transfer by direction, DBG must procure the payment to RPS Co of an amount to fund the Redemption.

69. In the event of Conversion, the amounts that RPS Co is obliged to pay on behalf of the RPS holder to acquire ordinary shares in DBG or the IPO Entity may be set off against the amounts payable by DBG to RPS Co in respect of subscribing for ordinary shares as provided under the Sponsorship Deed.

70. DBG agrees to provide RPS Co with all financial support reasonably requested (including by subscribing for fully paid ordinary shares in RPS Co or providing a debt instrument, guarantee or other form of financing) to pay for its establishment, ongoing costs and expenses and winding up (as required) and to fulfil its obligations under the Sponsorship Deed and RPS Terms.

71. It is intended that DBG will provide any necessary management and administrative support to RPS Co.

72. At the time of issue of the RPS, they will notionally represent up to 10% of the issued share capital of DBG, assuming a one for one conversion into DBG Shares at that time.

73. At the time of issue of the RPS, there is no certainty that a Redemption Event will occur.

Commissioner of Taxation

15 January 2025

Status: **not legally binding**

Appendix – Explanation

❶ *This Explanation 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.*

Table of Contents	Paragraph
Redeemable preference shares are equity interests	74
Redeemable preference shares are not traditional securities or qualifying securities	91
Redeemable preference shares are not assessable income at the time they are provided to the Head Office	101
<i>Non-cash business benefits</i>	111
<i>Section 15-15</i>	117
Tax implications for a Head Office on the transfer of redeemable preference shares to a Group Pharmacy	119
<i>Gain as ordinary income under section 6-5</i>	119
<i>Gain as statutory income under section 6-10</i>	121
Tax implications for Group Pharmacies on the acquisition of redeemable preference shares from a Head Office	133
<i>Gain as ordinary income under section 6-5</i>	133
<i>Deemed cost base where a Head Office and the Group Pharmacy are not dealing at arm's length at time of the transfer</i>	138
Tax implications for a Group Pharmacy or other holder (apart from a Head Office) on the permitted transfer of redeemable preference shares prior to Redemption under clause 8 of the RPS Terms	140
<i>Gain as ordinary income under section 6-5</i>	140
<i>Gain as statutory income under section 6-10</i>	142
Tax implications for a holder of redeemable preference shares on Redemption	150
<i>Gain as ordinary income under section 6-5</i>	150
<i>Gain as statutory income under section 6-10</i>	152
Direct value shifting rules in Division 725 do not apply to the Customer Equity Scheme	156

Redeemable preference shares are equity interests

74. A scheme gives rise to an equity interest in a company if, when the scheme comes into existence:

- the scheme satisfies the equity test in subsection 974-75(1) in relation to the company because of the existence of an interest (paragraph 974-70(1)(a)), and
- the interest is not characterised as, and does not form part of a larger interest that is characterised as, a debt interest in the company (paragraph 974-70(1)(b)).

Status: **not legally binding**

75. A scheme satisfies the equity test in relation to a company if it gives rise to an interest in the company as a member or stockholder (table item 1 of subsection 974-75(1)).

76. The CES satisfies the equity test as it provides holders of RPS with an interest in RPS Co as a member or stockholder.

77. Subsection 974-5(4) provides that if an interest satisfies both the debt test and the equity test it is to be treated as a debt interest and not an equity interest.

78. Subsection 974-15(1) provides that a scheme will give rise to a debt interest in an entity if the scheme, when it comes into existence, satisfies the debt test in subsection 974-20(1).

79. Subject to certain exceptions, subsection 974-20(1) provides that a scheme satisfies the debt test where the following requirements are satisfied:

- the scheme is a financing arrangement for the entity (paragraph 974-20(1)(a))
- the entity or a connected entity receives, or will receive, a financial benefit under the scheme (paragraph 974-20(1)(b))
 - the term ‘financial benefit’ is defined in subsection 974-160(1) as anything of economic value including property and services and anything that the regulations provide is a financial benefit
- an effectively non-contingent obligation (ENCO), as defined in section 974-135, for the entity or connected entity to provide a financial benefit exists (paragraph 974-20(1)(c))
- it is substantially more likely than not that the value of the financial benefit provided will at least equal that of the benefit received (paragraph 974-20(1)(d)), and
- the value of the benefit provided and received are not both nil (paragraph 974-20(1)(e)).

80. Pursuant to subsection 974-20(1), the financing arrangement requirement of a scheme does not have to be met if the entity is a company and table item 1 of the table in subsection 974-75(1) is satisfied.

81. RPS Co receives, or will receive, a financial benefit of \$0.01, being the Issue Price, under the scheme: paragraph 974-20(1)(b).

82. The concept of an ENCO is defined in section 995-1 to have the meaning in section 974-135. Subsection 974-135(1) states:

There is an **effectively non-contingent obligation** to take an action under a scheme if, having regard to the pricing, terms and conditions of the scheme, there is in substance or effect a non-contingent obligation (see subsections (3), (4) and (6)) to take that action.

83. Subsection 974-135 further provides:

- (3) An obligation is non-contingent if it is not contingent on any event, condition or situation (including the economic performance of the entity having the obligation or a connected entity of that entity), other than the ability or willingness of that entity or connected entity to meet the obligation.
- (4) The existence of the right of the holder of an interest that will or may convert into an equity interest in a company to convert the interest does not of itself make the issuer's obligation to repay the investment not non-contingent.

Status: **not legally binding**

- (5) An obligation to redeem a preference share is not contingent merely because there is a legislative requirement for the redemption amount to be met out of profits or a fresh issue of equity interests.
- (6) In determining whether there is in substance or effect a non-contingent obligation to take the action, have regard to the artificiality, or the contrived nature, of any contingency on which the obligation to take the action depends.

Note: The artificiality, or the contrived nature, of a contingency would tend to indicate that there is, in substance or effect, a non-contingent obligation to take that action.
- (7) An obligation of yours is not **effectively non-contingent** merely because you will suffer some detrimental practical or commercial consequences if you do not fulfil the obligation.

Note: For example, a contingent obligation to make payments in respect of an income security issued by an approved deposit-taking institution (ADI) is not effectively non-contingent merely because of the detrimental effect non-payment would have on the ADI's business.

84. In Taxation Ruling TR 2010/5 *Income tax: the relevance of 'economic compulsion' in deciding whether an issuer of a financing arrangement has an 'effectively non-contingent obligation' for the purposes of section 974-135 of the Income Tax Assessment Act 1997*, we reach the following conclusion about the ENCO test:

- 41. ... Subsection 974-10(2) provides that the debt test is to operate on the basis of the economic substance of the rights and obligations arising under the scheme.
- 42. Consistent with this object, the debt test largely turns on whether, from the issuer's perspective, objectively determined as at the time that the scheme under which the interest was issued came into existence, the issuer has ENCOs to provide adequate financial benefits. By virtue of the definition of ENCO, it is necessary to find whether the issuer has in substance or effect a non-contingent obligation to take relevant actions: the non-contingent obligation is to be found by having regard to the pricing, terms and conditions of that scheme.
- 43. This enquiry is therefore not at large and is constrained by the provisions of the legislation. While the essential enquiry is a broader enquiry than the mere recognition of rights and obligations that appear as a matter of legal form under the terms and conditions of the arrangement (because their substance or effect is to be considered), the enquiry is not so broad as to permit the identification and weighting of all possible consequences that arise from taking an action.

85. In Taxation Ruling TR 2008/3 *Income tax: debt/equity – identification of any 'effectively non-contingent obligation' of an issuer of a convertible note to provide 'financial benefits' for the purposes of Division 974 of the Income Tax Assessment Act 1997 if the note can be converted at any time at the issuer's discretion into shares that are equity interests in the issuer company*, we state:

- 38. ... where the provision of a financial benefit on an instrument is formally subject to a contingency, that formal contingency may be disregarded if, upon consideration of the pricing, terms and conditions of issue of an instrument, the substance or effect of the arrangement is that the financial benefit will be provided by the issuer, despite the formal contingency. Artificial or contrived contingencies may be disregarded (subsection 974-135(6)). A contingency that is immaterially remote, ... will be disregarded.
- 39. On the other hand, if the formal terms of issue do not contain an express formal contingency, but it is apparent (again, from consideration of the pricing, terms and conditions of the scheme) that there is, in substance or effect, an effective contingency that could prevent the provision of financial benefits, the obligation to provide financial benefits would be considered to be effectively contingent: the obligation will therefore not be 'effectively non-contingent'.

Status: **not legally binding**

40. If there is a formal contingency that could affect the issuer's obligation to provide a financial benefit, and that contingency is not to be disregarded for the reasons noted above, the ostensible intention of the provisions is that the obligation is to be considered to be contingent unless a specific statutory exception applies.

...

43. ... an issuer's right to convert the convertible note is ostensibly a relevant contingency for the purposes of the debt test: it relevantly affects the obligations of the issuer to repay the investment, and to make any periodic payments on the investment. The discretion that an issuer has about converting the note into an equity interest in the issuer, and bringing to an end any obligations of the issuer to provide any financial benefits that would repay the investment, is regarded as a formal contingency that could of itself preclude a finding that there is an 'effectively non-contingent obligation' to provide a financial benefit after the time that the conversion option could be exercised.

44. If the issuer of the convertible note can exercise its discretion at any time to convert the note into an equity interest in itself, the issuer can terminate at any time any requirement to provide financial benefits. Therefore, at the time of issue the provision of any financial benefits by the issuer in the future will be contingent upon the exercise of the issuer's discretion to convert. Unless additional matters are identified (that is, matters that are evident from consideration of the pricing, terms and conditions of the scheme under which the instrument was issued) that would lead one to conclude that, as a matter of substance or effect, the issuer would never exercise that discretion to convert in that way, the issuer will only have effectively contingent obligations to provide financial benefits, rather than effectively non-contingent obligations.

86. The RPS are provided under the CES and the intention is to encourage Head Office entities and Group Pharmacies to continue to support the DBG Group by purchasing products from nominated ranges. The RPS are not issued to raise finance for the DBG Group and have been priced at a nominal amount in the context of the scheme. The intent is to provide eligible Customers a contingent equity-like exposure to the DBG Group through the RPS which will be held at risk, as an incentive to support the businesses of the DBG Group.

87. Redemption of the RPS is at the discretion of RPS Co (as directed by DBG). The holder of an RPS has no right to request or require the redemption of an RPS. A Liquidity Event may not happen and there may be no final Redemption Date. The Redemption Dates are determined by the Board of DBG in its sole and absolute discretion and notified to RPS Co. The Prospectus lists a number of circumstances that may result in a postponing of redemption of RPS that relate to the economic performance of the DBG Group. Further, RPS Co may in its sole and absolute discretion, redeem the RPS by converting the RPS to fully paid ordinary shares in DBG or an IPO Entity. RPS Co is only bound to redeem the RPS if so directed by DBG under the Sponsorship Deed. Although RPS Co is committed to providing a benefit on Redemption, it cannot be said that a financial benefit is not contingent on any event, condition or situation other than the ability or willingness of RPS Co to meet the obligation.

88. Having regard to the pricing, terms and conditions of the CES, there is no ENCO for RPS Co to provide a financial benefit within the ambit of section 974-135.

89. Section 974-65 does not give the Commissioner the power to determine that the RPS is a debt interest because the RPS do not satisfy paragraphs 974-20(1)(a) or (c).

90. Therefore, the RPS issued by RPS Co under the CES should be characterised as equity interests (and not debt interests) under Division 974.

Status: **not legally binding**

Redeemable preference shares are not traditional securities or qualifying securities

91. Sections 26BB and 70B of the ITAA 1936 ensure that in most cases any profit or loss on the disposal of traditional securities that arises from arm's length dealings between the parties will be an assessable profit or deductible loss.

92. A traditional security is defined in subsection 26BB(1) of the ITAA 1936 as, in addition to other requirements, a security held by the taxpayer. The term 'security' is defined in subsection 26BB(1) by reference to subsection 159GP(1) of the ITAA 1936.

93. Division 16E of the ITAA 1936 imposes a statutory accruals regime on certain payments in relation to a security that is a qualifying security.

94. A qualifying security as defined in subsection 159GP(1) of the ITAA 1936, in addition to other requirements, must also be a security as defined in subsection 159GP(1).

95. Under subsection 159GP(1) of the ITAA 1936, 'security' means:

- (a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;
- (b) a deposit with a bank or other financial institution;
- (c) a secured or unsecured loan; or
- (d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

96. The Explanatory Memorandum to the Taxation Laws Amendment Bill (No 3) 1989, states that the term 'stock' in paragraph (a) of the definition of 'security' in subsection 159GP(1) of the ITAA 1936 does not include shares in the capital of a company.

97. Taxation Ruling TR 96/14 *Income tax: traditional securities* explains that the term 'or other security' in paragraph (a) of the definition in subsection 159GP(1) of the ITAA 1936 only encompasses instruments that evidence an obligation on the part of the issuer to pay an amount to the holder, whether during the term of the instrument or at its maturity, typically recognised as debt instruments (at paragraph 29). Further, paragraph 30 of TR 96/14 explains that having regard to paragraphs (a), (b) and (c) of the definition of security, only those contracts that have sufficient debt like obligations will usually fall under paragraph (d).

98. The RPS issued under the CES are not stock, a bond, debenture, certificate of entitlement, bill of exchange or a promissory note, a deposit with a bank or other financial institution or a loan.

99. Having regard to the RPS Terms, the holders of RPS cannot compel RPS Co to redeem the shares and RPS Co would only have such an obligation if and when so directed by DBG Health.

100. The obligations under the CES for the issue of RPS are not considered to fall within the term 'or other security' in paragraph (a) or have sufficient debt-like obligations to be contracts to which paragraph (d) of the definition of security in subsection 159GP(1) of the ITAA 1936 applies.

Redeemable preference shares are not assessable income at the time they are provided to the Head Office

101. Subsection 6-5(1) provides that the assessable income of a taxpayer includes income according to ordinary concepts. Ordinary income includes receipts that are an incident of the taxpayer's business (even if received as a result of an unusual transaction

Status: **not legally binding**

when compared to the usual business transactions entered into in the ordinary course of that business): *Commissioner of Taxation v Myer Emporium Ltd* [1987] HCA 18 (Myer); *GP International Pipecoaters Pty Ltd v Commissioner of Taxation (Cth)* [1990] HCA 25; *Commissioner of Taxation v Montgomery* [1999] HCA 34, per Gaudron, Gummow, Kirby and Hayne JJ at [113–114]; *Commissioner of Taxation v Unilever Australia Securities Ltd* [1995] FCA 63, per Lockhart and Hill JJ; and *Victoria Power Networks Pty Ltd v Commissioner of Taxation* [2019] FCA 77.

102. Subsections 6-5(2) and (4) provide that ordinary income will be assessable in the income year in which it is derived.

103. Ordinary income is derived when a gain has ‘come home’ to the taxpayer in a realised or immediately realisable form: *Commissioner of Taxes (SA) v Executor Trustee and Agency Co of South Australia Ltd* [1938] HCA 69 (Carden’s case); *Blank v Commissioner of Taxation* [2016] HCA 42. In *Henderson v Commissioner of Taxation* [1970] HCA 62, it was held that income of an accruals taxpayer is not derived until it is recoverable as a debt. Further, for gains to have come home to the taxpayer, the gain needs to have been completely made such that there is ‘neither legal nor business unsoundness in regarding them without qualification as income derived’: *Arthur Murray (NSW) Pty Ltd v Commissioner of Taxation (Cth)* [1965] HCA 58 at [318], per Barwick CJ, Kitto and Taylor JJ. In *Ballarat Brewing Co Ltd v Commissioner of Taxation (Cth)* [1951] HCA 35, Fullagar J. looked to the ‘truth and reality of the situation’ in determining whether and at what point income had been derived.

104. In *Commissioner of Taxation v White* [2010] FCA 730 at [25], Gordon J stated: ‘income does not have to be received as money. It is sufficient if it is received in the form of money’s worth’ citing *The Commissioner of Taxation of the Commonwealth of Australia v. Cooke, Judith Anne & Ors* [1980] FCA 46.

105. In *Barratt, M.M. & Ors v Commissioner of Taxation* [1992] FCA 378, involving an accruals taxpayer, Gummow J (with Northrop and Drummond JJ concurring) noted:

No doubt a debt that is presently recoverable by action generally will be an amount “derived” in the relevant sense by the creditor. The creditor will have a present right to receive the amount in question, something both earned and quantified, without the presence of any element of contingency or defeasibility. At the other end of the scale, where the right of the taxpayer is contingent, there will be no derivation before the contingency is satisfied: see Parsons, “Income Taxation in Australia”, §11.49. Nor will there be derivation if the debt is yet to be quantified: *Farnsworth v Federal Commissioner of Taxation* (1949) [9 A.T.D. 33 at 37] 78 C.L.R. 504 at 513 per Latham C.J.

106. The RPS are provided to the Head Office entity as an incident of conducting its business operations which includes to negotiate for the acquisition of pharmaceutical and health, wellbeing and beauty products on behalf of its Group Pharmacies. The RPS are accordingly received by a Head Office entity on revenue account.

107. However, under the CES:

- Head Offices must pay a subscription price of \$0.01 per RPS.
- Redemption of the RPS is at the discretion of RPS Co or DBG, with the Head Office having no right to demand payment of the Redemption Amount or to compel that the RPS be redeemed by RPS Co.
- Head Offices cannot transfer the RPS (other than in limited circumstances) without consent, and then only for the Issue Price.
- No gain may be made if, for example, there is no Liquidity Event or Final Redemption Date or the Customer becomes a Bad leaver under the Bad

Status: **not legally binding**

Leaver provisions of the RPS Terms. Where the Customer is a Bad Leaver (for example, the Customer fails to meet a yearly target), the RPS may only be redeemed for the Issue Price.

108. For these reasons, it can be concluded that at the time the RPS are issued to the Head Office there is no present right to receive a quantifiable gain without the presence of any element of contingency. Having regard to 'the truth and reality of the situation', no gain has come home to the Head Office in a realisable or immediately realisable form.

109. A recoverable debt would come into existence with regard to the RPS at the time of a Redemption Event or on a disposal of the RPS for valuable consideration by the holder of the RPS.

110. Therefore, no income is derived by the Head Office at the time of issue of the RPS under subsections 6-5(2) and (4), and accordingly, no amount is included in the assessable income of the Head Office as a result of the issue of the RPS under section 6-5.

Non-cash business benefits

111. Sections 21 and 21A of the ITAA 1936, to the extent presently relevant, contain the following provisions:

21(1) **[Non-cash consideration]**

Where, upon any transaction, any consideration is paid or given otherwise than in cash, the money value of that consideration shall, for the purposes of this Act, be deemed to have been paid or given.

21(2) **[Effect of section]**

This section has effect subject to section 21A.

21A(1) For the purposes of this Act, in determining the income derived by a taxpayer, a non-cash business benefit that is not convertible to cash shall be treated as if it were convertible to cash.

21A(2) For the purposes of this Act, if a non-cash business benefit (whether or not convertible to cash) is income derived by a taxpayer:

- (a) the benefit shall be brought into account at its arm's length value reduced by the recipient's contribution (if any); and
- (b) if the benefit is not convertible to cash – in determining the arm's length value of the benefit, any conditions that would prevent or restrict the conversion of the benefit to cash shall be disregarded.

...

21A(5) In this section:

arm's length value, in relation to a non-cash business benefit, means:

- (a) the amount that the recipient could reasonably be expected to have been required to pay to obtain the benefit from the provider under a transaction where the parties to the transaction are dealing with each other at arm's length in relation to the transaction; or
- (b) if such an amount cannot be practically determined – such amount as the Commissioner considers reasonable.

income derived by a taxpayer means income derived by a taxpayer in carrying on a business for the purpose of gaining or producing assessable income.

Status: **not legally binding**

non-cash business benefit means property or services provided after 31 August 1988:

- (a) wholly or partly in respect of a business relationship; or
- (b) wholly or partly for or in relation directly or indirectly to a business relationship.

...

recipient's contribution, in relation to a non-cash business benefit, means the amount of any consideration paid to the provider by the recipient in respect of the provision of the benefit, reduced by the amount of any reimbursement paid to the recipient in respect of that consideration.

21A(6) Notwithstanding section 21, the consideration referred to in the definition of **recipient's contribution** in subsection (5) of this section is consideration in money.

112. In *Victoria Power Networks Pty Ltd v Commissioner of Taxation* [2020] FCAFC 169, the Court explains that the test in paragraph 21A(2)(a) of the ITAA 1936 requires a determination of, objectively, what parties dealing with each other at arm's length would have reached as an arm's length price. Where the actual dealing between the parties is at arm's length, the dealing will reflect what price an arm's length party in the market in which the relevant transaction took place would have agreed to pay for the benefit (at [95–100], per Colvin J and [110–121, per Thawley J).

113. An RPS is a non-cash business benefit as it is property (a share) provided after 13 August 1988 in respect of a business relationship.

114. However, section 21A of the ITAA 1936 is not a charging provision. It does not deem any benefit in the form of property or services to be income. Rather, it determines that the amount to be brought to account is the amount that the taxpayer would have paid the provider for the property or services under an arm's length transaction reduced by the recipient's contribution. For the reasons given earlier, there was no derivation of income when the RPS are issued.

115. Furthermore, RPS Co and the Head Offices are dealing at arm's length and the actual dealing reflected what price the recipient of the benefit (Head Office) could reasonably be expected to have been required to pay to RPS Co to obtain the RPS, having regard to the terms of the CES and the business context in which the arrangement is made.

116. Therefore, when the RPS are issued to a Head Office, the Issue Price of the RPS is the arm's length value of the RPS for the purposes of paragraph 21A(2)(a) of the ITAA 1936, and when reduced by the recipient's contribution (also the Issue Price) the amount of the non-cash business benefit is nil.

Section 15-15

117. Section 15-15 states that a taxpayer's assessable income includes profit arising from the carrying on or carrying out of a profit-making undertaking or plan but does not apply to a profit that is assessable as ordinary income under section 6-5 or arises in respect of the sale of property acquired on or after 20 September 1985.

118. Section 15-15 would not apply to the issue of RPS because if a profit was derived as a result of the receipt of the RPS by a Head Office, that profit would be assessable as ordinary income under section 6-5.

Status: **not legally binding**

Tax implications for a Head Office on the transfer of redeemable preference shares to a Group Pharmacy

Gain as ordinary income under section 6-5

119. A profit or gain made in the ordinary course of carrying on a business constitutes income and a gain made otherwise than in the ordinary course of carrying on the business may also be ordinary income when it arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain (*Myer*).

120. Under the CES, the RPS can only be transferred by the Head Office to a Group Pharmacy for an amount equal to their Issue Price (\$0.01 per RPS). On this basis, there will not be any gain for a Head Office at the time that it transfers the RPS.

Gain as statutory income under section 6-10

121. A CGT asset is any kind of property, or legal or equitable right that is not property. Shares in a company are explicitly listed as an example of a CGT asset under section 108-5.

122. Accordingly, the RPS held by the Head Office will constitute CGT assets.

123. CGT event A1 happens if you dispose of a CGT asset: subsection 104-10(1). A taxpayer makes a capital gain if the capital proceeds from the disposal are more than the asset's cost base: subsection 104-10(4).

124. Section 116-20 states that the capital proceeds are the money and market value of property you have received (or are entitled to receive) in respect of the event happening. Under section 116-30, the capital proceeds from a CGT event are replaced with the market value of the CGT asset to the extent that there are nil capital proceeds or the capital proceeds are more or less than the market value of the asset and the parties did not deal with each other at arm's length in connection with the event.

125. CGT event A1 will arise as a result of the transfer of the RPS from the Head Office to Group Pharmacies.

126. Under the RPS Terms that have been determined by DBG and RPS Co, the Head Office will acquire each RPS for the Issue Price of \$0.01 and is only allowed to transfer the RPS to Group Pharmacies for an equivalent amount.

127. Having regard to section 116-30 and all of the RPS Terms, it is accepted that (all other things being equal to the time of issue) the capital proceeds of the RPS, on transfer by a Head Office to a Group Pharmacy will not be more than the Issue Price where a Redemption Event has not been announced or is otherwise considered imminent. Accordingly, the capital proceeds from the transfer of the RPS will be equal to the cost base of the RPS and as such, the Head Office will not derive a capital gain from the disposal of the RPS to the Group Pharmacies.

128. The capital proceeds would be deemed to be the market value of the RPS at that time where:

- a Head Office and Group Pharmacy are not dealing with each other at arm's length
- the transfer would be a permitted transfer under clause 8 of the RPS Terms, and
- the market value of the RPS is higher than the Issue Price, for example, due to a Redemption Event being announced prior to the transfer of the RPS.

Status: **not legally binding**

129. In this event, a capital gain would arise to the Head Office for the difference between the market value and its cost base (equal to the Issue Price of each RPS).

130. The phrase 'not deal with each other at arm's length', or similar, has been discussed at length in multiple public rulings including Taxation Ruling TR 94/14 *Income tax: application of Division 13 of Part III (international profit shifting) – some basic concepts underlying the operation of Division 13 and some circumstances in which section 136AD will be applied* with respect to transfer pricing, and TR 96/14 regarding Traditional Securities referred to elsewhere in this ruling. Excerpts from TR 94/14:

284. The expression "not dealing at arm's length with each other", is not defined, though it is used in a number of provisions throughout the ITAA. In *Barnsdall v. FC of T*, 88 ATC 4565; (1988) 19 ATR 1352, Davies J, in considering the expression "not dealing with each other at arm's length" in the context of subsection 26AAA(4), held that:

"(the) term should not be read as if the words "dealing with" were not present. The Commissioner is required to be satisfied not merely of a connection between a taxpayer and the person to whom the taxpayer transferred, but also of the fact that they were not dealing with each other at arm's length. A finding as to a connection between the parties is simply a step in the course of reasoning and will not be determinative unless it leads to the ultimate conclusion."

...

286. The legislative formula in paragraph (b) of subsections 136AD(1) - (3) focuses on the type of dealing between the parties rather than merely on the relationship between them. Hence, the presence or absence of such matters as those listed in paragraph 277 above will not necessarily be determinative of whether or not any of the parties to an "agreement" were dealing at arm's length with each other.

287. In *The Trustee for the Estate of the late AW Furse No 5 Will Trust v FC of T* (supra), Hill J, in relation to the expression "not dealing with each other at arm's length" in subsection 102AG(3) of the ITAA, said that:

"What is required in determining whether parties dealt with each other in respect of a particular dealing at arm's length is an assessment whether in respect of that dealing they dealt with each other as arm's length parties would normally do, so that the outcome of their dealing is a matter of *real bargaining*." (emphasis added)

288. It will therefore be relevant to also consider whether the outcome of dealings between the relevant parties is a matter of real bargaining, in terms of the consideration that passed between them as a consequence of their dealings and the overall manner and effect of what the parties did, for the purpose of being satisfied as to whether or not any two or more of the parties to the "agreement" were dealing at arm's length with each other.

131. Taxation Ruling TR 2014/5 *Income tax: matrimonial property proceedings and payments of money or transfers of property by a private company to a shareholder (or their associate)* provides a summary of more recent court decisions (footnotes omitted):

98. Later in *Granby Pty Ltd v Federal Commissioner of Taxation (Grandy)* [(1995) 30 ATR 400] Lee J explained:

The expression 'dealing with each other at arm's length' involves an analysis of the manner in which the parties to a transaction conducted themselves in forming that transaction. (emphasis added)

99. His Honour went on to explain that in the context of the former paragraph 160ZH(9)(c) [present section 112-20 regarding deemed market value cost base] of the ITAA 1936, the phrase 'at arm's length' means 'at least, that the parties to a transaction have acted severally and independently in forming their bargain'.

Status: **not legally binding**

100. More recently, the Full Federal Court in *Axa Asia Pacific Holdings* [(2010) 81 ATR 180] reinforced the meaning of 'dealing' in context as one necessitating bargaining between the parties. At paragraph 105, Edmonds J and Gordon J explain:

The reference in *Furse* 21 ATR 1123 to "real bargaining" is significant. It focusses on actual dealing between the parties: see also ... *Barnsdall v Federal Commissioner of Taxation* (1988) 81 ALR 173. ...

...

103. A similar approach was taken in *Industry Research & Development Board v. Bridgestone Australia Ltd* [(2004) FCAFC 56]. Tamberlin, Sackville and Selway JJ said, in the context of section 39C of the *Industry Research and Development Act 1986*, that what is required is a:

... a comparison between the actual contract and terms between the parties and the range of hypothetical transactions and contracts that might be entered into between parties dealing at arm's length

132. The scheme to which this Ruling applies allows a transfer of the RPS by a Head Office to its Group Pharmacies at a future time. An assessment will be required by the Head Office at a transfer time as to whether it is dealing at arm's length with the respective Group Pharmacies to which RPS are transferred. While the RPS Terms only allow a Head Office to Transfer the RPS for \$0.01, market value consideration may be deemed received where the parties are not dealing with each other at arm's length, taking into account the considerations discussed in paragraphs 128 to 131 of this Ruling.

Tax implications for Group Pharmacies on the acquisition of redeemable preference shares from a Head Office

Gain as ordinary income under section 6-5

133. The RPS may be acquired by Group Pharmacies under the terms of the CES. They are issued to Head Office entities and may be acquired by Group Pharmacies for \$0.01 each as part of a scheme designed to incentivise the Group Pharmacies to purchase trading stock from certain wholesalers and from specified ranges of products. They are acquired by the Group Pharmacy as an incident of conducting their business operations, which includes being part of a buyer group to acquire pharmaceutical and health, wellbeing and beauty products for retail sale in their pharmacy.

134. Absent a Redemption Event, Group Pharmacies are unable to transfer or otherwise realise the RPS, apart from transfers to associates of the Group Pharmacy permitted under clause 8 of the RPS Terms. Transfers by such transferees are similarly restricted to associates of a Key Person of a Group Pharmacy under clause 8.

135. In these circumstances, no amount of income will be *derived* by a Group Pharmacy at the time that the RPS is acquired by that Group Pharmacy from the Head Office. At the time of acquisition, no gain will come home to the Group Pharmacy in a realised or immediately realisable form for the same or similar reasons that there is no derivation of income at the time that the Head Office acquired the RPS.

136. Even in the event that a Redemption Event is known to be imminent at the time of a Group Pharmacy's acquisition of the RPS, such that the arm's length value of the RPS may be considered to be higher than the \$0.01 acquisition consideration payable under the CES, section 21A of the ITAA 1936 together with section 6-5 would not apply to include any amount in the assessable income of a Group Pharmacy at the time of acquisition. No recoverable debt will have come into existence in relation to any gain that may be made on redemption or sale of the RPS before redemption, and no gain will otherwise be realised or considered to have been received in an immediately realisable form at the time of

Status: **not legally binding**

acquisition, given the contingent nature of the gain (including based on the restrictions on the Group Pharmacy's ability to dispose of the RPS and that RPS Co has discretion to both redeem and to cancel an announced Redemption at any time).

137. Accordingly, no income will come home to a Group Pharmacy at the acquisition time.

Deemed cost base where a Head Office and the Group Pharmacy are not dealing at arm's length at time of the transfer

138. Where a Head Office and Group Pharmacy are not dealing at arm's length at the time of the transfer, and the market value of the RPS is higher than the Issue Price, for example, due to an upcoming Redemption Event, then the Group Pharmacy's cost base for capital gains tax purposes would be equal to the market value of the RPS at the time of acquisition, pursuant to section 112-20.

139. This deemed cost base would not impact the implications outlined in paragraphs 133 to 137 of this Ruling for the Group Pharmacy pursuant to section 6-5 (that is, there would be no deemed deduction). However, the deemed cost base would be taken into account in determining any capital gains tax implications on disposal of the RPS by the Group Pharmacy, including on any conversion to ordinary shares in DBG, pursuant to section 130-60 (table item 2).

Tax implications for a Group Pharmacy or other holder (apart from a Head Office) on the permitted transfer of redeemable preference shares prior to Redemption under clause 8 of the RPS Terms

Gain as ordinary income under section 6-5

140. As noted earlier, a gain made in the ordinary course of carrying on a business constitutes income and a gain made otherwise than in the ordinary course of carrying on the business may also be ordinary income when it arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or gain (*Myer*).

141. Under the CES, the RPS can be transferred by a Group Pharmacy to an associated entity, or by such an associate to other associates, under clause 8 of the RPS Terms. Any consideration received on disposal which exceeds the amount paid on acquisition by the relevant RPS holder will be assessable as a gain under section 6-5.

Gain as statutory income under section 6-10

142. As noted earlier in paragraph 121 of this Ruling, the RPS held by a Group Pharmacy or associated entity will constitute CGT assets.

143. CGT event A1 happens if you dispose of a CGT asset: subsection 104-10(1). A taxpayer makes a capital gain if the capital proceeds from the disposal are more than the asset's cost base: subsection 104-10(4).

144. Section 116-20 states that the capital proceeds are the money and market value of property you have received (or are entitled to receive) in respect of the event happening. Under section 116-30, the capital proceeds from a CGT event are replaced with the market value of the CGT asset to the extent that there are nil capital proceeds or the capital proceeds are more or less than the market value of the asset and the parties did not deal with each other at arm's length in connection with the event.

Status: **not legally binding**

145. CGT event A1 will arise as a result of the transfer of the RPS from a Group Pharmacy to an associate as permitted in clause 8 of the RPS Terms or between such associates as also permitted therein.

146. There is no restriction regarding consideration allowed for transfers between a Group Pharmacy and associates (or 2 or more such associates) under clause 8 of the RPS Terms. Accordingly, under these terms, transfers may be for nil consideration or any other consideration as agreed.

147. However, for income tax purposes, on the basis that such transfers would be between parties who are not dealing with each other at arm's length, the capital proceeds will be deemed to be equal to the market value of the RPS at the time of the transfer, pursuant to section 116-30.

148. The market value of the RPS may exceed the Issue Price where a Redemption Event has been announced or is considered imminent for any reason.

149. Where the capital proceeds exceed the disposing entity's cost base for the RPS, that entity will make a capital gain equal to the amount of the excess. The capital gain will be reduced under section 118-20 to the extent any amount is included in the entity's assessable income under section 6-5 in relation to the transfer.

Tax implications for a holder of redeemable preference shares on Redemption

Gain as ordinary income under section 6-5

150. On Redemption, a holder of RPS will derive ordinary income that is included in the RPS Holder's assessable income under section 6-5.

151. The amount included in the assessable income of the holder of the RPS under section 6-5 will be the amount of the net gain that has come home to the RPS holder at the time of Redemption. This amount will be the Redemption Amount (either paid in cash or applied to subscribe for shares in DBG under a Conversion) reduced by the price paid by the RPS Holder to acquire the RPS (on issue or pursuant to a later permitted transfer under clause 8 of the RPS Terms).

Gain as statutory income under section 6-10

152. CGT event A1 happens if you dispose of a CGT asset: subsection 104-10(1). A taxpayer makes a capital gain if the capital proceeds from the disposal are more than the asset's cost base: subsection 104-10(4).

153. CGT event C2 (which deals with cancellation, surrender and similar endings) happens if a taxpayer's ownership of an intangible CGT asset ends by the asset being redeemed or cancelled. The timing of the event is when the asset ends (subsection 104-25(2)(b)). A capital gain is made if the capital proceeds from the ending are more than the asset's cost base (subsection 104-25(3)).

154. However, any capital gain made by a holder of RPS upon Redemption is reduced by the amount assessed as ordinary income under section 6-5: section 118-20.

155. In the event of a Redemption consisting of a conversion of RPS into ordinary shares in DBG Health, the cost base of the shares in DBG Health received by the holder of the RPS (at conversion) will include the holder's cost base in their RPS at the time of conversion and the amount of the reduction under section 118-20 referred to in paragraph 154 of this Ruling, pursuant to section 130-60.

Status: **not legally binding**

Direct value shifting rules in Division 725 do not apply to the Customer Equity Scheme

156. The direct value shifting rules apply where a scheme effectively results in a value shift between equity or loan interests in an entity (a company or trust) to other equity or loan interests in that entity, where the entity is controlled (for value shifting purposes) by another entity. From the perspective of the owners of those interests, such value shifts distort the relationship between the assets' market value and their cost base without generating either a taxing point, or other tax adjustments. The direct value shifting rules seek to address this distortion.

157. There is a direct value shift under a scheme involving equity interests in an entity (target entity) where there is a decrease in the market value of some equity interest (down interests) and an increase or issue at a discount of other equity interests (up interests) (section 725-145).

158. Under the CES, the issue of RPS to Head Offices (noting that the Head Offices may subsequently transfer the RPS to Group Pharmacies for an amount equal to the Issue Price) occurs at market value. RPS Co and the Head Office are dealing at arm's length and the value subscribed to the issue of RPS is considered to be an arm's length price having regard to the terms of the CES.

159. The issue of additional ordinary shares by RPS Co to DBG will be undertaken solely to fund a Redemption of the RPS by RPS Co. As RPS Co will not have any significant assets or profits under the Scheme and, at the time of issue, would have a liability to pay the Redemption Amount, the market value of both ordinary shares already on issue and those being newly issued should be nil or nominal. There will be no issue of shares at a discount.

160. Further, the RPS will have their value determined pursuant to the RPS Terms and the redemption liability would not increase or decrease in value as a result of the subscription for new shares by DBG.

161. Accordingly, there is no decrease or increase in the market value of any interests in RPS Co, or issue of interests at a discount, under the scheme.

162. Moreover, under the terms of the CES, the relevant net gain for the holder of RPS made on Redemption of the RPS will be assessable income under section 6-5. A CGT event also happens on Redemption but the capital gain made as a result of the Redemption is reduced by application of section 118-20.

163. Consequently, there is a taxing point under the income tax law that taxes the gain received by the holder of the RPS on Redemption. There is no untaxed value shift giving rise to a taxing point for the holder under Division 725.

Status: **not legally binding**

References

Related Rulings/Determinations:

TR 2008/3; TR 2010/5; TR 94/14; TR 96/14;
TR 2014/5

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 21
- ITAA 1936 21A
- ITAA 1936 21A(2)(a)
- ITAA 1936 26BB
- ITAA 1936 26BB(1)
- ITAA 1936 70B
- ITAA 1936 102AG(3)
- ITAA 1936 Div 16E
- ITAA 1936 159GP(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 6-5(2)
- ITAA 1997 6-5(4)
- ITAA 1997 6-10
- ITAA 1997 15-15
- ITAA 1997 104-10
- ITAA 1997 104-10(1)
- ITAA 1997 104-10(4)
- ITAA 1997 104-25(2)(b)
- ITAA 1997 104-25(3)
- ITAA 1997 108-5
- ITAA 1997 110-25
- ITAA 1997 110-25(1)
- ITAA 1997 112-20
- ITAA 1997 Div 13
- ITAA 1997 116-20
- ITAA 1997 116-30
- ITAA 1997 118-20
- ITAA 1997 130-60
- ITAA 1997 Div 230
- ITAA 1997 Div 725
- ITAA 1997 725-145
- ITAA 1997 Div 974
- ITAA 1997 974-5(4)
- ITAA 1997 974-10(2)
- ITAA 1997 974-15(1)
- ITAA 1997 974-20(1)
- ITAA 1997 974-20(1)(a)
- ITAA 1997 974-20(1)(b)
- ITAA 1997 974-20(1)(c)
- ITAA 1997 974-20(1)(d)
- ITAA 1997 974-20(1)(e)
- ITAA 1997 974-65
- ITAA 1997 974-70(1)(a)
- ITAA 1997 974-70(1)(b)
- ITAA 1997 974-75(1)
- ITAA 1997 974-135
- ITAA 1997 974-135(1)
- ITAA 1997 974-135(3)

- ITAA 1997 974-135(4)
- ITAA 1997 974-135(5)
- ITAA 1997 974-135(6)
- ITAA 1997 974-135(7)
- ITAA 1997 974-160(1)
- ITAA 1997 995-1
- Industry Research and Development Act 1986 39C (Repealed)

Cases relied on:

- Arthur Murray (NSW) Pty Ltd v Commissioner of Taxation (Cth) [1965] HCA 58; 114 CLR 314; 14 ATD 98
- Ballarat Brewing Co Ltd v Commissioner of Taxation (Cth) [1951] HCA 35; 82 CLR 364; [1951] ALR 603; 9 ATD 254
- Barratt, M.M. & Ors v Commissioner of Taxation [1992] FCA 378; 36 FCR 222; 92 ATC 4275; 23 ATR 339; 107 ALR 385
- Blank v Commissioner of Taxation [2016] HCA 42; 258 CLR 439; 2016 ATC 20-587; 104 ATR 41; 91 ALJR 14
- Commissioner of Taxation v AXA Asia Pacific Holdings Ltd [2010] FCAFC 134; 189 FCR 204; 2010 ATC 20-224; [2011] ALMD 2345; 81 ATR 180
- Commissioner of Taxation (Cth) v Montgomery [1999] HCA 34; 198 CLR 639; 42 ATR 475; 164 ALR 435; 99 ATC 4749
- Commissioner of Taxation v Myer Emporium Ltd [1987] HCA 18; 163 CLR 199; 87 ATC 4363; 71 ALR 28; 18 ATR 693
- Commissioner of Taxation v White [2010] FCA 730; 79 ATR 498; 2010 ATC 20-195; [2011] ALMD 2340
- Commissioner of Taxation v Unilever Australia Securities Ltd [1995] FCA 63; 56 FCR 152; 127 ALR 437; 30 ATR 134; 95 ATC 4117
- Commissioner of Taxes (SA) v Executor Trustee and Agency Company of South Australia Ltd [1938] HCA 69; 63 CLR 108; 12 ALJR 407; 5 ATD 98; [1939] ALR 81
- GP International Pipecoaters Pty Ltd v Commissioner of Taxation (Cth) [1990] HCA 25; 170 CLR 124; 90 ATC 4413; 21 ATR 1
- Granby Pty Ltd v The Commissioner of Taxation of the Commonwealth of Australia [1995] FCA 259; 30 ATR 400; 95 ATC 4240; 129 ALR 503

- Henderson v Commissioner of Taxation (Cth) [1970] HCA 62; 119 CLR 612; 44 ALJR 115; 1 ATR 596; 70 ATC 4016
 - Industry Research & Development Board v Bridgestone Australia Limited [2004] FCAFC 56; 136 FCR 47; 2004 ATC 4240; 55 ATR 142; ALMD 4226;
 - Barnsdall, D.G & Anor v Commissioner of Taxation [1988] FCA 291; 19 ATR 1352; 88 ATC 4565; 81 ALR 173
 - The Commissioner of Taxation of the Commonwealth of Australia v Cooke, Judith Anne & Ors [1980] FCA 46; 80 ATC 4140; 10 ATR 696; 42 FLR 403; 29 ALR 202
 - The Trustee for Estate of the Late A.W. Furse No. 5 Will Trust v The Commissioner of Taxation [1990] FCA 676; 91 ATC 4007; 21 ATR 1123
 - Victoria Power Networks Pty Ltd v Commissioner of Taxation [2019] FCA 77; 2019 ATC 20-682; 109 ATR 537
 - Victoria Power Networks Pty Ltd v Commissioner of Taxation [2020] FCAFC 169; 2020 ATC 20-768; 112 ATR 353; 385 ALR 64
-

ATO references

NO: 1-132UX27L
 ISSN: 2205-5517
 BSL: PW
 ATOLaw topic: Income tax ~~ Common concepts ~~ Debt and equity interests ~~ Effectively non-contingent obligation
 Tax integrity measures ~~ General value shifting regime

© AUSTRALIAN TAXATION OFFICE FOR THE COMMONWEALTH OF AUSTRALIA

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).