TR 1999/D9 - Income tax: capital gains: application of Division 20 of Part IIIA of the Income Tax Assessment Act 1936 and Division 149 of the Income Tax Assessment Act 1997 to public entities

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Draft Taxation Ruling

Income tax: capital gains: application of Division 20 of Part IIIA of the *Income Tax Assessment Act 1936* and Division 149 of the *Income Tax Assessment Act 1997* to public entities

Preamble

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.
DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

1. This Ruling addresses issues that affect public entities (listed public companies, publicly traded unit trusts, mutual insurance companies, mutual affiliate companies and companies that are beneficially owned, directly or indirectly, by one or more of these) when applying Division 20 of Part IIIA of the *Income Tax Assessment Act 1936* (the 1936 Act) and Division 149 of the *Income Tax Assessment Act 1997* (the 1997 Act). It concerns the determinations that public entities are required to make under Division 20 and, in some cases, under Division 149.

2. The Ruling also outlines matters that determine whether the Commissioner can be satisfied, or think it reasonable to assume, under either Division that the same ultimate owners held majority underlying interests in a public entity's assets at particular times specified in the law. The advice in the Ruling about these matters is intended to assist public entities that have to prepare information for the Commissioner to consider. Public entities affected by this Ruling should not assume the Commissioner would be satisfied, or think it reasonable to assume, that continuity of majority underlying interests has been maintained in their particular case, but should apply for a private ruling.

Class of person/arrangement

3. This Ruling applies to public entities with assets that were acquired before 20 September 1985 (pre-CGT assets) on a test day under Division 20 or Division 149. The Ruling does not apply to entities at any time when they were covered by section 160ZZS of the 1936 Act or Subdivision 149-B of the 1997 Act.

Key terms

4. In this Ruling we use terms that are defined in the 1997 Act. In some cases different terms are used in the 1936 Act. The following table lists the terms from the 1997 Act and where to find their definitions, and gives the corresponding term used in the 1936 Act.

Term in 1997 Act	Definition	Term in 1936 Act
majority underlying interests	subsection 149-15(1)	majority underlying interests
mutual affiliate company	section 121AC of the 1936 Act	mutual insurance organisation
mutual insurance company	section 121AB of the 1936 Act	mutual insurance organisation
publicly traded unit trust	subsection 149-50(2)	publicly traded unit trust
starting day	subsection 149-60(1)	base time
test day	subsection 149-55(2)	test time
ultimate owner	subsection 149-15(3)	natural person
underlying interest	subsection 149-15(2)	underlying interest

Background

5. Under Division 20 of Part IIIA of the 1936 Act and Division 149 of the 1997 Act, entities that have pre-CGT assets must be able to demonstrate that the ultimate owners who had the majority underlying interests in the assets at the starting day still have the majority underlying interests in those assets. A public entity's starting day is 19 September 1985 or an alternative day within the period 1 July 1985 to 30 June 1986, the choice of which gives a reasonable approximation of underlying interests as at 19 September 1985. If an

entity is unable to demonstrate this continuity of underlying interests, its assets stop being pre-CGT assets.

6. Public entities must show that the majority underlying interests have been maintained at particular test days ascertained under the law. All public entities had a test day on 20 January 1997 (although the determination that public entities had to make about majority underlying interests at 20 January 1997 was not required until 16 August 1999; *Taxation Laws Amendment Act (No 4) 1999* provided for a second test day to apply to all public entities on 30 June 1999). Public entities other than mutual insurance companies and mutual affiliate companies also have a test day whenever there is abnormal trading in their shares or units or in the shares or units of their ultimate parent.

7. For test days before 30 June 1999, a public entity was required to make a formal determination as to whether the majority underlying interests in its pre-CGT assets were held by the same ultimate owners who held the majority underlying interests at the public entity's starting day. If the public entity had insufficient information to make a determination that the majority underlying interests had been maintained at a test day before 30 June 1999, it could present information to satisfy the Commissioner under subsection 160ZZSC(2) or 160ZZSD(2) of the 1936 Act or subsection149-70(3) of the 1997 Act that the majority underlying interests had been maintained or should be assumed to have been maintained.

8. For test days on and after 30 June 1999, a public entity that wishes to preserve the pre-CGT status of its assets must provide written evidence to satisfy the Commissioner, or from which the Commissioner thinks it reasonable to assume, that the majority underlying interests have been maintained.

9. Although there are guidelines in this Ruling for exercise of the Commissioner's power in subsection 160ZZSC(2) or 160ZZSD(2) and subsection 149-70(3), it is essential that each case is dealt with on its merits. Officers exercising the power should record in detail the matters they have taken into account in the course of exercising it.

Ruling

Standard of evidence required

10. If a public entity cannot demonstrate, at a test day before 30 June 1999, that majority underlying interests in a pre-CGT asset were held by ultimate owners who also held majority underlying interests in the asset at the entity's starting day, subsection 160ZZSC(2) or 160ZZSD(2) or subsection 149-70(3) may apply. Under these subsections, the asset does not stop being a pre-CGT asset if the

Commissioner is satisfied, or thinks it reasonable to assume, that majority underlying interests in the asset were held by ultimate owners who had majority underlying interests in the asset at the end of the starting day.

11. We are satisfied, or think it reasonable to make the necessary assumption, under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3) if, having regard to all the information available, it is more probable than not that more than 50% of the underlying interests in assets of the public entity were held by the same ultimate owners at the starting day and the test day.

12. For the test day at 30 June 1999 and any later test day, a public entity may ask the Commissioner to make a decision about majority underlying interests under subsection 149-60(1). As a result of the amendments made to sections 149-55 and 149-60 by *the Taxation Laws Amendment Act (No 4) 1999*, the public entity must now provide written evidence to satisfy the Commissioner, or give the Commissioner reasonable grounds to assume, that the majority underlying interests are held by the same ultimate owners at the starting day and the relevant test day. In our view, the Commissioner can only be satisfied, and is only entitled to make the necessary assumption, if the public entity's evidence is sufficient to allow the firm conclusion to be drawn that majority underlying interests are held by the same ultimate owners.

Reliance on the statutory tracing rules

13. For test days before 30 June 1999, a public company (a listed public company or a company that is beneficially owned, directly or indirectly, by one or more listed public companies, publicly traded unit trusts, mutual insurance companies or mutual affiliate companies) or a publicly traded unit trust may use the tracing rules in Subdivisions E, F and G of Division 20 in Part IIIA of the 1936 Act and Subdivisions 149-D, 149-E and 149-F of the 1997 Act. In paragraphs 17 and 46 to 48 of Taxation Ruling TR 1999/4, we accepted that a public company or publicly traded unit trust may ask us to apply the tracing rules when it makes an application under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3).

14. Generally, in deciding whether there are sufficient grounds to be satisfied, or reasonably to assume, under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3), that the majority underlying interests were held by the same ultimate owners, we accept the results of applying the tracing rules. We accept also the results of applying the notional holder tracing rule to shares held by a clearinghouse in the United States of America, as explained in paragraphs 49 to 54 of TR 1999/4. We do not require a public company or publicly traded unit trust to go behind the tracing rules by examining underlying interests further.

15. We would not accept the results of applying the tracing rules if there were indications that the shareholder or unitholder interests had been manipulated to gain a greater advantage from the rules.

Overseas mutual insurance companies

16. The tracing rule in Subdivision F of Division 20 of Part IIIA and Subdivision 149-E for interests held by mutual insurance companies, does not apply to mutual insurance companies registered outside Australia. However, if mutual insurance companies in a particular overseas country invest in shares or units for the same reasons as Australian mutual insurance companies, hold shares or units as long-term investments and have members who remain members for long periods, it is reasonable to assume there has been a degree of continuity in the underlying interests held by their members.

17. In deciding, for the purpose of subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3), what level of continuity should reasonably be assumed for underlying interests held through overseas mutual insurance companies in a particular public company or publicly traded unit trust, we take into consideration:

- for what length of time, on average, the mutual insurance companies hold the shares or units they purchase;
- for what purposes the mutual insurance companies invest in shares or units;
- what proportion of members of the mutual insurance companies continue to be members for long periods (for example, for more than ten years);
- whether some products offered by the mutual insurance companies are for shorter periods; and, if so, what proportion of the members use only those products; and
- whether there has been substantial recruitment of new members or substantial loss of membership in the mutual insurance company sector in that country at any time since September 1985.

Interests held through family discretionary trusts

18. Taxation Ruling IT 2340 contains advice to assist trustees of family discretionary trusts to determine whether the pre-CGT status of the trust assets had been maintained under section 160ZZS of the 1936 Act. Although this advice applied only to assets held by family discretionary trusts, we adopt the same principles where another entity needs to trace the underlying interests in its pre-CGT assets and a

family discretionary trust has shares, units or other interests in that other entity. We treat shares/units/interests held by the family trust as if they were held by the family members directly, so long as distributions from the family discretionary trust continue to be made to or for the benefit of the particular family.

19. These principles are applied where distributions from the family trust are made directly to members of the relevant family, but also where the trustee makes distributions to other persons or entities to be applied for the benefit of family members. A distribution is applied for the benefit of a family member if it is used to meet expenses incurred by the family member or is paid to the family member indirectly through another entity or entities controlled by the family. However, if one of the interposed entities makes a distribution to a person who is not a family member and who does not apply the distribution for a family member's benefit, underlying interests in the public entity's pre-CGT assets are, to that extent, not treated as being held by the family members.

20. We take this approach in deciding whether subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3) applies or where, on or after 30 June 1999, an entity gives evidence to the Commissioner under amended section 149-55. Public entities cannot apply these principles to make a determination under section 160ZZSA or 149-55 in respect of a test day before 30 June 1999.

Interests held through nominees

Bearer shares

21. The tracing rule in Subdivision E of Division 20 in Part IIIA of the 1936 Act, and Subdivision 149-D of the 1997 Act, permits public companies and publicly traded unit trusts to treat shareholdings and unitholdings of less than 1% as if they were held by a notional holder. This rule makes it easier for the companies and publicly traded unit trusts to show that majority underlying interests are held by the same ultimate owners at the starting day and at a test day.

22. The benefit of the notional holder tracing rule is not available where interests of less than 1% are held by a nominee that holds, in aggregate, more than 1% of the shares or units. In this situation, public companies and publicly traded unit trusts should attempt to provide other information about the length of time for which those interests are likely to have been held, enabling the Commissioner to make a reasonable assumption under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3).

23. Similarly, alternative sources of information must be provided in relation to European public companies that have issued bearer shares, to satisfy the Commissioner, or give the Commissioner

reasonable grounds to assume, that the same ultimate owners held majority underlying interests at the starting day and at a test day.

24. This option to provide statistical and other alternative information to the Commissioner is only available for test days before 30 June 1999. We consider that, for the test day on 30 June 1999 and later test days, the legislation permits the Commissioner to reach a conclusion about majority underlying interests only on the basis of written evidence about the underlying interests in bearer shares or in the shares or units held by nominees.

Redeemable preference shares

25. Public companies may have difficulty demonstrating that the continuity of majority underlying interests has been maintained if they are required to take into account any redeemable preference shares on issue at the starting day or at a test day. In recognition of this difficulty, Taxation Determination TD 28 permitted entities to exclude redeemable preference shares from their tracing of underlying interests under section 160ZZS of the 1936 Act if the redeemable preference shares were issued under an arrangement that was treated for all purposes as a financing arrangement.

26. Public entities examining majority underlying interests in their pre-CGT assets under Division 20 of Part IIIA or Division 149 may continue to rely on the concession in TD 28, at their option, for all test days before, on and after 30 June 1999.

Separate notional holders

Superannuation funds, government bodies, etc

27. When applying the notional holder rule in Subdivision E of Division 20 in Part IIIA and Subdivision 149-D, a public company or publicly traded unit trust must determine separately:

- the number of its own shares or units held by persons or entities with holdings of less than 1%; and
- holdings of shares or units of less than 1% in each other public company or publicly traded unit trust that has an interest in its shares or units.

28. The legislation creates one notional holder for the head public company or publicly traded unit trust and a separate notional holder for each interposed public company or publicly traded unit trust. Underlying interests that a particular notional holder is taken to have at a test day can only be counted in a determination under Division 20 or Division 149 if the same notional holder is taken to have had underlying interests at the starting day.

29. In the same way, each superannuation fund, approved deposit fund and special company with more than 50 members and each government corporation is treated as a separate individual when applying the tracing rule in Subdivision F of Division 20 in Part IIIA and Subdivision 149-E. The underlying interests represented by the shares or units it holds are only covered by these Subdivisions if that particular fund, company or corporation held interests at both the public company's or publicly traded unit trust's starting day and test day.

Revising a determination

30. A public entity that has failed to make a valid determination at a particular test day because of an error in examining its records of underlying interests or because it misunderstood the law, should make a new determination. The new determination must be made within the time allowed for making that determination under Division 20 or Division 149 or an extended time allowed by the Commissioner.

31. A public company or publicly traded unit trust may also make a new determination in lieu of an earlier valid determination made on a different basis. It may do this, for example, to make use of one of the statutory tracing rules, to adopt the advice in TR 1999/4 about shares held by clearinghouses, or to take account of newly discovered records of underlying interests. The new determination must be made within the time allowed by the law for making the original determination or within any extended time allowed by the Commissioner. The public company or publicly traded unit trust should elect within the time allowed for making the determination to treat one of the determinations as the determination to be given effect under Division 20 or Division 149.

Extensions of time for determinations or to provide evidence

32. The Commissioner may extend the period for making a determination about majority underlying interests under subsection 160ZZSA(2) of the 1936 Act or subsection 149-55(1) of the 1997 Act. Extra time may also be allowed under amended subsection 149-55(1) to a public entity to give the Commissioner written evidence about majority underlying interests for the test day on 30 June 1999 or a later test day.

33. In view of the extensions of time already allowed for making determinations under Division 20 of Part IIIA and Division 149, few entities should require further time to gather available information about underlying interests. Further time would generally only be allowed in cases where a public entity initially made a determination and new records have come to light shortly before, or after, the time

for making a new determination expired. An application should have been made as soon as the need for an extension of time became apparent.

34. An extension of time may be allowed if a public entity has inadvertently made an invalid determination. The public entity must show that it misunderstood the requirements of the law and that misunderstanding was reasonable in the circumstances. If we are not satisfied that due care was taken with the original purported determination, section 160ZZSB or section 149-65 must be allowed to apply as described in paragraphs 26 to 28 of TR 1999/4.

35. In each of these situations, and also for applications for extra time to give written evidence to the Commissioner in relation to a test day on or after 30 June 1999, we consider the following matters:

- whether the entity requested all necessary information as soon as possible after the test day or (if the test day was before 11 March 1999) as soon as possible after 11 March 1999;
- whether follow-up action was taken promptly where the information was not received within a reasonable time;
- whether as the entity discovered that further information would be needed, it requested the further information immediately;
- whether there is reason to believe that all outstanding information can be obtained within a reasonable time if an extension is given; and
- whether it is likely that the information when received will enable the entity to determine that the majority underlying interests in its pre-CGT assets have not changed.

Date of effect

36. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Standard of evidence required

For test days before 30 June 1999

37. Paragraphs 31 to 43 of TR 1999/4 discuss a number of matters that are commonly relevant to an exercise of the Commissioner's power under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3) (i.e., in respect of test days before 30 June 1999). However, as stated in paragraph 44 of the Ruling, we are prepared to take into account information of any kind that:

- might indicate the same ultimate owners have or have not continued to hold certain underlying interests; or
- could assist us in drawing inferences on a reasonable basis about the extent to which underlying interests have or have not continued to be held by the same ultimate owners.

We also consider submissions arguing that it would be reasonable to assume that underlying interests have continued to be held by the same ultimate owners in a particular case.

38. The power in subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3) is exercised in a public entity's favour if, having regard to all the information available, it is more probable than not that more than 50% of underlying interests in its assets were held by the same ultimate owners at the entity's starting day and at the test day. **Examples 1** and **2** at paragraphs 79 to 83 of this Ruling illustrate.

For test days on and after 30 June 1999

39. The examples at paragraphs 79 to 83 relate to test days before 30 June 1999. For test days on or after 30 June 1999 the tracing rules in Subdivisions E and F of Division 20 and Subdivisions 149-D and 149-E no longer apply and the standard of information required of public entities changes. The public entity must provide written evidence showing, or giving the Commissioner reasonable grounds to assume, that the majority underlying interests were held by the same ultimate owners. The choice of these terms in the law is understood to mean, first, that it is the public entity's task to provide all of the material needed to make a decision; and second, that the material provided must be of a kind that allows firm conclusions to be drawn (rather than, for example, suppositions) about the underlying interests at a particular time.

40. In view of the change, we consider that it is not open to us, for test days on or after 30 June 1999, to make decisions based on such

considerations as statistical information, the extent of market trading in shares or units, or assumptions about the continuity of underlying interests in entities that are shareholders, unitholders or members of a public entity. A public entity must provide evidence about, specifically, underlying interests in its pre-CGT assets at the starting day and the relevant test day and the evidence must be sufficient to satisfy us, or make it reasonable to assume, that the majority underlying interests were held at the end of the test day by ultimate owners who had majority underlying interests at the end of the starting day.

Reliance on the statutory tracing rules

41. When making a determination about majority underlying interests under Division 20 of Part IIIA of the 1936 Act, a public company or a publicly traded unit trust may use the tracing rules in Subdivisions E, F and G. The same tracing rules are available under Subdivisions 149-D, 149-E and 149-F in the 1997 Act for test days before 30 June 1999. The law does not make clear whether a public company or publicly traded unit trust may rely on these same tracing rules if it applies to the Commissioner to exercise the power in subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3).

42. In paragraphs 17 and 46 to 48 of TR 1999/4, we accepted that a public company or publicly traded unit trust may ask us to apply the tracing rules when it makes an application under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3). We made no commitment in the Ruling to make our decision solely on that basis.

43. Generally, we do not require a public company or publicly traded unit trust to go behind the tracing rules by examining underlying interests further. We accept as proven the level of continuity of underlying interests that results from applying those rules. For example, assume a public company had a notional holder interest of 40% at both the starting day and a test day, and a complying superannuation fund with more than 50 members held a further 6%. In deciding whether there are sufficient grounds to be satisfied, or reasonably to assume, that the continuity of majority underlying interests had been maintained, we would accept without further enquiry that at least 46% of the underlying interests were held at the starting day and the test day by the same ultimate owners. Similarly, we adopt the results of applying the notional holder tracing rule to shares held by a clearinghouse in the United States of America, as explained in paragraphs 49 to 54 of TR 1999/4.

44. We would not accept the results of applying the tracing rules if there were indications that the shareholder or unitholder interests had been manipulated to gain a greater advantage from the rules.

Overseas mutual insurance companies

45. The tracing rule in Subdivision F of Division 20 and Subdivision 149-E for interests held by mutual insurance companies does not apply to mutual insurance companies registered outside Australia. Because of this, for example, if an Australian public company has an overseas parent some of the shares in which are held by an overseas mutual insurance company, the Australian company cannot use the tracing rule for the interests held by the overseas mutual insurance company.

46. We recognise that there may be mutual insurance companies in other countries that invest in shares or units for the same reasons as Australian mutual insurance companies, hold shares or units as long-term investments and whose members also remain members for long periods. If we are satisfied that the mutual insurance companies in a particular overseas country share these features of Australian mutual insurance companies, it is reasonable to assume that there has been a degree of continuity in the underlying interests held by members of the overseas mutual insurance company. An assumption on this basis would only be made for a test day before 30 June 1999.

47. In deciding what level of continuity should reasonably be assumed for underlying interests held through overseas mutual insurance companies in a particular public company or publicly traded unit trust, we take into consideration:

- for what length of time, on average, the mutual insurance companies hold the shares or units they purchase;
- for what purposes the mutual insurance companies invest in shares or units;
- what proportion of members of the mutual insurance companies continue to be members for long periods (for example, for more than ten years);
- whether some products offered by the mutual insurance companies are for shorter periods; and, if so, what proportion of the members use only those products; and
- whether there has been substantial recruitment of new members or substantial loss of membership in the mutual insurance company sector in that country at any time since September 1985.

Interests held through family discretionary trusts

48. IT 2340 looked at the application of subsection 160ZZS(1) of the 1936 Act to pre-CGT assets held by family discretionary trusts. It ruled in part:

> '6. Where a trustee continues to administer a trust for the benefit of members of a particular family, for example, it will not bring section 160ZZS into application merely because distributions to family members who are beneficiaries are made in such amounts and to such of those beneficiaries as the trustee determines in the exercise of his discretion.
>
> …
>
> '8. On the other hand where, by the exercise of a trustee's discretionary powers to appoint beneficiaries or by amendment of the trust deed, there is in practical effect a change of 50% or more in the underlying interests in the trust assets - such as where the members of a new family are substituted as recipients of distributions from the trust in place of persons who were formerly the object of such distributions - the section would have its intended application as described.'

49. Besides applying IT 2340 to pre-CGT assets held by family discretionary trusts, we adopt the same principles where public entities need to trace the underlying interests in their pre-CGT assets and a family discretionary trust has shares, units or other interests in the public entity. Specifically, for tracing purposes, we treat shares/units/interests held by the family discretionary trust as if they were held by the family members directly, so long as distributions from the family discretionary trust continue to be made to or for the benefit of the particular family. An example is at paragraph 84 of this Ruling.

50. These principles are applied even if the distributions from the family discretionary trust are not made directly to members of the family, but are applied for their benefit. So, trust income distributed to another person and applied by that person to pay (for example) family members' education expenses may be treated as distributions to the family members themselves. Also, income distributed to another entity controlled by the family, which is then further distributed directly or indirectly to family members or to an entity or person for application for the family members' benefit, may be treated as distributions to the family members.

51. Where distributions are made from a family discretionary trust through another entity or entities to the family members, it is necessary to examine the income and capital distributions made by each of the interposed entities. If an interposed entity, in the 1986 income year or in any later year up to the year in which a test day

occurs, makes a distribution to a person who is not a family member, underlying interests in the pre-CGT assets should, to that extent, not be treated as being held by the family members. (In the case of an interposed entity that has not made any distributions of income or of capital, any changes to the shareholders or the beneficiaries or classes of beneficiaries specified in the trust deed are taken into account.)

52. This concessionary approach to interests held by family discretionary trusts can only be taken where an entity applies to the Commissioner to exercise the power in subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3); or where, on or after 30 June 1999, an entity gives evidence to the Commissioner under the amended section 149-55. Public entities cannot apply these principles to make a determination under section 160ZZSA or 149-55 in respect of a test day before 30 June 1999.

Interests held through nominees

53. Representations have been received that the Commissioner should allow public companies and publicly traded unit trusts to 'look through' nominees that hold their shares or units. Often, individuals who have an interest of less than 1% in a public company or trust, hold their interests through a nominee company that owns, in total, more than 1% of the public company's shares or the trust's units. If the individuals had held shares in the public company or units in the publicly traded unit trust directly, their interest would be included in the notional holder interest. According to the representations, it is unreasonable that the benefit of the notional holder rule is not available because the individuals hold their interests through a nominee company.

54. We are unable to accept this extension of the notional holder rule. We understand that the position of entities whose shares or units are held by nominees was considered during development of the tracing rules. Having regard to the policy objectives of the law, it was decided not to adopt more concessionary rules than those currently provided for in Division 20/Division 149. (This decision is reflected in paragraph 6.109 of the explanatory memorandum to Taxation Laws Amendment Bill (No 1) 1997. Essentially, the same rules appear also in Subdivisions 166-F and 166-G of the 1997 Act, relating to deductions for tax losses and bad debts from previous years.) It would not be appropriate for the Commissioner to change this legislative policy by administrative action.

55. Public companies and publicly traded unit trusts whose shares or units are held by nominees, should attempt to provide other information on which a reasonable assumption can be based under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3). In particular, paragraph 38 of TR 1999/4 advises: 'Where interests in the pre-CGT

assets of a public entity are held indirectly through one or more interposed companies or trusts … we may be able, using information about the average length of time interests are held through companies or trusts of that kind, to estimate how likely it is that some of the interests have been beneficially held by the same natural persons since the base time'.

Bearer shares

56. Public companies in some European countries issue some of their shares as bearer shares. There is no register of the holders of bearer shares and it appears they can be bought and sold without notice to the company or any stock exchange. According to advice we have received, there are no statutory provisions under which the holders of bearer shares could be required to disclose their shareholdings, unless they hold substantial interests (at least 5% of the voting rights) in the company. For the 1985/86 year, even the holders of substantial interests may not have been obliged to disclose their holdings of bearer shares.

57. On the basis of this advice it seems that companies are unable to identify the owners of bearer shares at any particular time for the purpose of tracing underlying interests. If the ultimate owners who had underlying interests in assets in 1985/86 cannot be identified, subsection 160ZZSA(3) of the 1936 Act and subsection 149-60(3) of the 1997 Act require the companies to assume that those underlying interests in their assets have changed.

58. Various suggestions have been made for overcoming the problems with bearer shares. It has been proposed that bearer shares be disregarded for the purposes of Division 20/Division 149, or that companies that have issued bearer shares should only have to examine the underlying interests in their assets when there was abnormal trading in their shares. None of the suggestions is consistent with the policy of the law, that entities with pre-CGT assets should be required to ascertain whether the continuity of majority underlying interests has been maintained since 19 September 1985 or the relevant starting day.

59. When considering an application under subsection 160ZZSC(2), 160ZZSD(2) or 149-70(3) we apply the same standards to companies with bearer shares as we do to all other public entities. Taking into account the whole of the underlying interests that underlying owners have in the company (including underlying interests represented by bearer shares) there must be sufficient information to satisfy us, or furnish reasonable grounds to assume, that the majority underlying interests have not changed. Any kind of evidence that might assist us to form an opinion about the extent of changes in underlying interests can be provided in support of the application. Where bearer shares are concerned, relevant information

might include, for example, statistical or survey data about the average length of time that such shares are held between trades, the proportion of shares that are typically held by institutions, individuals, superannuation funds and so on, the characteristics of share ownership by these different types of shareholders and any other material on which reasonable assumptions could be based.

60. As discussed earlier (under '**Standard of evidence required**'), for a test day on or after 30 June 1999, evidence must be provided about underlying interests as a whole that allows firm conclusions to be drawn about the majority underlying interests at the starting day and the test day.

Redeemable preference shares

61. The provisions in Division 20 and Division 149 that define underlying interests (sections 160ZZRR, 160ZZRS and160ZZRT; subsections 149-15(2), (4) and (5)) make no distinction between interests held by holders of ordinary shares and interests held by holders of redeemable preference shares. In strict terms of the law, interests held by both holders of ordinary shares and holders of redeemable preference shares should be taken into account in determining who had the majority underlying interests at any particular time.

62. If public entities choose to take redeemable preference shares into account, they are entitled under the law to do so. As an alternative, however, we also give effect to TD 28, which provides:

> 'The issue or redemption of redeemable preference shares by a company will be taken into account in applying the majority underlying interest test in section 160ZZS unless on the facts, the arrangement is seen to be a financing arrangement and treated as such by the parties for all purposes (including the section 46 rebate).'

63. TD 28 represents a concession to make it easier to prove continuity of majority underlying interests. It recognises that redeemable preference shares are sometimes used as a short-term financing instrument and that taking them into account may distort any comparison of underlying interests. We allow public entities to rely on the concession in TD 28 when it operates to their advantage, for all test days before, on and after 30 June 1999.

Separate notional holders

64. The notional holder rule in Subdivision E of Division 20 and Subdivision 149-D allows a public company or publicly traded unit trust to treat holdings of shares or units of less than 1% as if they were

held by a single notional individual. If another public company or publicly traded unit trust has an interest in the public company or units in the publicly traded unit trust, holdings of shares or units of less than 1% in the interposed public company or publicly traded unit trust may also be treated as if they were held by a single notional individual.

65. In applying the notional holder rule it is important to bear in mind that the legislation creates one notional holder for the head public company or publicly traded unit trust and a separate notional holder for each interposed public company or publicly traded unit trust. Underlying interests that a particular notional holder is taken to have at a test day can only be counted in a determination under Division 20 or Division 149 if that same notional holder is taken to have had underlying interests at the starting day. **Example 4** at paragraph 86 of this Ruling gives an illustration.

Superannuation funds, government bodies, etc

66. A similar principle applies for the tracing rule in Subdivision F of Division 20 and Subdivision 149-E, for interests held by certain superannuation funds, approved deposit funds, special companies and government corporations. Each fund, company and government corporation is treated as a separate individual and the underlying interests represented by the shares or units it holds are only covered by the tracing rule if that particular fund, company or corporation held interests at both the public company's or publicly traded unit trust's starting day and test day.

67. So, for example, if a municipal corporation held shares in a public company at the public company's starting day, but transferred them before the test day to another municipal corporation, the underlying interests that those shares represent could not be treated as having been held throughout by the same ultimate owner.

Revising a determination

68. In some circumstances a public entity that has made a determination about majority underlying interests under Division 20 or Division 149 may want to change the determination.

- After making the determination the public entity may become aware that records it relied on were incorrect or it made an assumption that was not authorised by Division 20/Division 149.
- Further records may become available about underlying interests from which it appears that the majority underlying interests had been maintained.

- A public company or publicly traded unit trust may have chosen initially not to use the notional holder rule to make its determination (for example, at 20 January 1997) because it assumed that the Commissioner would exercise the power in section 160ZZSQ of the 1936 Act or section 149-140 of the 1997 Act. With the repeal of section 160ZZSQ and section 149-140 with retrospective effect in *Taxation Laws Amendment Act (No 4) 1999*, the company or trust may want to reassess whether majority underlying interests had changed using the statutory tracing rules.

69. If a public entity discovers that it relied on incorrect records or unauthorised assumptions to make its purported determination, it must make a new determination. The first attempted determination, based on an erroneous understanding of the facts or the law, is not a valid determination under Division 20/Division 149. The new determination must be made within the time allowed for making that determination under Division 20 or Division 149 or an extended time allowed by the Commissioner.

70. A public company or publicly traded unit trust that has made a valid determination but wants to change the basis on which it was made (for example, by using one of the statutory tracing rules or taking further records into account) may also make a new determination. The new determination must be made within the time allowed by the law for making the original determination or within any extended time allowed by the Commissioner. If an entity has made valid determinations on two different bases, in this way, it should elect within the time allowed for making the determination to treat one of them as the determination to be given effect under Division 20 or Division 149.

Extensions of time for determinations or to provide evidence

71. We anticipate that public entities may ask for extensions of time to make determinations (i.e., for test days before 30 June 1999) in three situations:

- where the time for making a determination expires while the entity is still trying to obtain information about underlying interests;
- where the entity wishes to make a determination on a new basis and it decides to do so after the time for making a fresh determination has expired; or

- where the entity is found to have made an invalid determination and the error is discovered after the time for making a fresh determination has expired.

Information still outstanding

72. We expect most requests in this first category to be refused. Because of the changes to Division 20 and Division 149 in *Taxation Laws Amendment Act (No 4) 1999*, public entities were given an extension of time, until one month after Assent to the Act, to make their determinations as at 20 January 1997 or at any later date of abnormal trading. The exact changes to be made to the law have been known since the Bill was introduced into the Parliament on 11 March 1999. Only in very exceptional cases would this extended time have been insufficient to gather all available information about underlying interests.

73. In deciding whether to grant a further extension in cases of this first kind, we consider whether:

- the entity requested all necessary information as soon as possible after the test day or (if the test day was before 11 March 1999) as soon as possible after 11 March 1999;
- follow-up action was taken promptly where the information was not received within a reasonable time;
- as the entity discovered that further information would be needed, it requested the further information immediately;
- there is reason to believe that all outstanding information can be obtained within a reasonable time if an extension is given; and
- it is likely that the information when received will enable the entity to determine that the majority underlying interests in its pre-CGT assets have not changed.

Revised determinations

74. A public company or publicly traded unit trust that wishes to make a revised determination relying on the notional holder rule or other tracing rule should generally not need an extension of time to make the determination. *Taxation Laws Amendment Act (No 4) 1999*, which repealed section 160ZZSQ and section 149-140, was introduced into the Parliament as Taxation Laws Amendment Bill (No 4) 1999 on 11 March 1999. Public companies had a little more

than five months from that time to make a determination on the new basis. Since little additional information would be required, we can foresee few circumstances in which an extended period would be allowed.

75. An extension may be warranted in a case where a public entity initially made a determination and new records have come to light shortly before, or after, the time for making a new determination expired. An application should have been made as soon as the need for an extension of time became apparent.

76. If a public company requires a substantial amount of additional information to make the revised determination, a decision is made whether to grant an extension of time taking into account the considerations listed in paragraph 73 above.

Previous determination invalid

77. If a public entity has made an invalid determination (for example, because it relied on assumptions not authorised by Division 20/Division 149) an extension would be granted if we are satisfied that the error, and therefore the invalid determination, was made inadvertently. To justify being allowed an extension, the public entity must show that it misunderstood the requirements of the law and that misunderstanding was reasonable in the circumstances. If we are not satisfied that due care was taken with the original purported determination, section 160ZZSB or section 149-65 must be allowed to apply as described in paragraphs 26 to 28 of TR 1999/4.

Test days on or after 30 June 1999

78. Following the enactment of *Taxation Laws Amendment Act (No 4) 1999*, some entities may ask for extra time to give evidence to the Commissioner in relation to a test day on or after 30 June 1999. These applications would be decided by applying the five considerations in paragraph 73 above.

Examples

Example 1: standard of evidence

79. AB Ltd, a listed public company, has been able to demonstrate at 20 January 1997 using the tracing rules available under Division 20 that 45% of the underlying interests in its assets have been maintained by the same ultimate owners. In addition, a listed investment company has held 12% of AB's shares since before 20 September 1985. No information is available about shareholders in the

investment company, but assume that published statistics about such companies indicate that almost all shareholders are natural persons and, on average, keep their shares for over 20 years.

80. In this situation it would be reasonable to assume that approximately half of those underlying interests in AB's assets that are held through the interposed investment company have been held by the same ultimate owners over the eleven year period since 19 September 1985. This level of continuity, added to the 45% established by AB using the tracing rules, implies a total continuity of more than 50% of the underlying interests in AB's assets. The power in subsection 160ZZSC(2) would be exercised in this case.

Example 2: standard of evidence

81. Listed public company CD Ltd has also established that 45% of the underlying interests in its assets have been maintained by the same ultimate owners. In an application under subsection 160ZZSC(2), CD advises that trustees of two private trusts each held 3% of its shares at all times since 19 September 1985. Several small private companies held a further 8% in total.

82. CD has evidence that one of the private trusts is a discretionary family trust that has distributed the whole of its net income within one family group throughout the period. Members of the family are also entitled to the whole of any distribution of capital. No information is available about the other trust ('The J Smith Trust') or the private companies.

83. The Commissioner's power would not be exercised in CD's favour. We would accept that 48% of underlying interests were held by the same ultimate owners. We might suspect that The J Smith Trust is a family trust (and the interest it holds might qualify as a continuing interest under IT 2340) but, in the absence of any information about this trust or the private companies, there is no basis for drawing any conclusions about underlying interests greater than 48%.

Example 3: family discretionary trusts

84. The White Family Trust has shares in Green Co-operative. Green Co-operative has pre-CGT assets. For the year ended 30 June 1986 and several years after that, all the net income of the White Family Trust was distributed to Mr and Mrs White. Since then, distributions have been made in some years to Mrs White and the Whites' children, and sometimes to the children only. No distributions of capital have been made, but under the trust deed the trustee may distribute capital only to members of the White family.

85. We would accept in these circumstances that the underlying interests in Green Co-operative's pre-CGT assets that are held through the White Family Trust have been held by the same ultimate owners since 19 September 1985.

Example 4: notional holder tracing rule

86. Public company EF Ltd conducted a business with certain assets at 19 September 1985. In 1992 EF incorporated a new company GH Pty Ltd and rolled over the pre-CGT business and assets into it. Later, GH listed on the stock market, EF Ltd retaining a majority interest of 55%.

87. If new company GH chooses to use the notional holder rule on the test day at 20 January 1997 there are two relevant notional holders: GH's notional holder and (because EF Ltd still holds shares in GH) EF's notional holder. Suppose 35% of the shares in GH are held on the test day by entities and individuals each having less than a 1% interest. That is, GH's notional holder interest on the test day is 35%. This 35% interest must be compared with GH's notional holder interest at the starting day. Since GH did not exist in 1985/86 it had no notional holder interest at that time. Its 35% notional holder interest must be disregarded under Division 20.

88. Assume that at its starting day, 50% of public company EF's shares were held by entities and individuals each having less than a 1% interest. At the test day that figure was 60%. Applying the notional holder rule, GH may assume that EF's notional holder held 50% of the underlying interests in the rolled over pre-CGT assets at the starting day. At the test day EF's notional holder is taken to have an interest of 50% in EF's assets, being the lower of the 50% interest at the test day and the 60% interest at the starting day. EF's notional holder therefore has an interest of 27.5% (i.e., 55% of 50%) at the test day in the rolled-over pre-CGT assets, now held by GH. This 27.5% notional holder interest may be taken into account in GH's determination under Division 20.

89. Note that if GH had existed at the starting day and had had a notional holder interest of its own of 10%, this 10% would be added to EF's notional holder interest (assume still 27.5%) to determine the aggregate interest held by the notional holders in GH's assets (37.5%).

Detailed contents list

90. Below is a detailed contents list for this Ruling:

Your comments

91. If you wish to comment on this draft Ruling, please send your comments promptly by 24 September 1999 to:

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Commissioner of Taxation
11 August 1999

Previous draft:

Related Rulings/Determinations:
IT 2340; IT 2408; TD 28; TR 1999/4

Subject references:
- approved deposit fund
- base time
- bearer shares
- capital gains
- continuity of majority underlying interests
- determination
- discretion
- discretionary trusts
- extensions of time
- family trusts
- government bodies
- mutual affiliate company
- mutual insurance companies
- mutual insurance organisations
- nominees
- notional single shareholder or unitholder
- public company
- public entities
- publicly traded unit trusts
- redeemable preference shares
- special companies
- starting day
- superannuation fund
- test day
- test time

- tracing of ownership and interests
- tracing rules
- ultimate owners
- underlying ownership and interests

Legislative references:

- ITAA36 Pt IIIA Div 20
- ITAA36 Pt IIIA Div 20 Subdiv E
- ITAA36 Pt IIIA Div 20 Subdiv F
- ITAA36 Pt IIIA Div 20 Subdiv G
- ITAA36 121AB
- ITAA36 121AC
- ITAA36 160ZZRR
- ITAA36 160ZZRS
- ITAA36 160ZZRT
- ITAA36 160ZZS
- ITAA36 160ZZSA
- ITAA36 160ZZSA(2)
- ITAA36 160ZZSA(3)
- ITAA36 160ZZSB
- ITAA36 160ZZSC(2)
- ITAA36 160ZZSD(2)
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- ITAA97 Div 149
- ITAA97 Subdiv 149-D
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- ITAA97 149-15(2)
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- ITAA97 149-15(5)
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- ITAA97 149-60(1)
- ITAA97 149-60(3)
- ITAA97 149-65
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- ITAA97 149-140

Case references:

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