TD 2006/77 - Income tax: capital gains: are all classes of shares (other than redeemable shares) issued by a company taken into account in determining if the company has a significant individual under section 152-55 of the Income Tax Assessment Act 1997?

Taxation Determination

Income tax: capital gains: are all classes of shares (other than redeemable shares) issued by a company taken into account in determining if the company has a significant individual under section 152-55 of the *Income Tax Assessment Act 1997*?

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

[**Note:** This is a consolidated version of this document. Refer to the Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]

Ruling

1. Yes. All classes of shares (other than redeemable shares) issued by a company are taken into account in determining if the company has a significant individual under section 152-55 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Example 1

2. *Bedrock Co has two different classes of shares, A and B, which have equal distribution rights. Only the A class shares have voting rights. Each class of shares is held by different shareholders – the A class shares being held in equal proportions by Fred and Barney and the B class shares being held in equal proportions by their respective wives, Wilma and Betty.*

3. *The directors of Bedrock Co can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares. There is the possibility of any of the shareholders receiving 50% of a distribution from the company, depending on the exercise of the directors' discretion.*

4. *In this situation, Bedrock Co does not have a significant individual. There is no specific individual who has the right to receive at least 20% of any distribution the company may make. Fred and Barney (who each hold 50% of the voting power) might receive 50% of a distribution or they might not receive anything at all, depending on how the directors exercise their discretion.*

Example 2

5. *A company has two different classes of shares, A and B, which have equal voting and distribution rights. Isaac holds 20% of the shares of each class. The directors can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares.*

6. *In this situation, the company does have a significant individual. Isaac holds 20% of the voting power and, regardless of how the directors' discretion is exercised, Isaac will always receive 20% of any distribution made by the company.*

Example 3

7. *A company has A class shares and one D class share issued to a key employee. Gus holds 20% of the A class shares, which have full voting and distribution rights. The D class share has dividend rights only, payable at the discretion of the directors.*

8. *The company does not have a significant individual. Gus may receive 20% of a distribution if the directors do not exercise their discretion to make a distribution to the D class shareholder, but he will receive less than 20% of the distribution if the discretion is exercised. That is, Gus does not have the right to receive at least 20% of any distribution made. His 'notional' 20% interest is reduced to below 20% because of the directors' ability to make distributions to the D class shareholder.*

Example 4

9. *XYZ Co has 100 ordinary shares and 1 redeemable preference share on issue. Michelle and ABC Co each own 20 ordinary shares. Catherine owns the redeemable preference share.*

10. *The redeemable preference share has voting rights equal to the ordinary shares, preferential dividend rights, a return of capital right but no right to participate in surplus capital on winding up. The ordinary shares have voting rights, dividend rights and rights to participate in surplus capital on winding up.*

11. *In this situation, the redeemable preference share is ignored for the purpose of determining if XYZ Co has a significant individual. Accordingly, as Michelle has the right to exercise at least 20% of the voting power in the company and receive at least 20% of any distribution the company may make (excluding redeemable shares), she is a significant individual of XYZ Co.*

Date of effect

12. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of the determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Note: the amendments applied to this Determination on 19 December 2012 apply to CGT events happening in and after the 2006-07 income years.

Commissioner of Taxation
20 December 2006

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Explanation

13. An individual is a significant individual in a company at a time, if at that time, the individual has a small business participation percentage in the company of at least 20% (section 152-55 of the ITAA 1997). An entity's small business participation percentage in another entity at a time is the percentage that is the sum of the entity's direct small business participation percentage and indirect small business participation percentage in the other entity at that time (section 152-65 of the ITAA 1997).

14. An entity's direct small business participation percentage in a company is the smallest of the percentage of voting power, the percentage of any dividend the company may pay or the percentage of any distribution of capital the company may make that the entity has because of holding the legal and equitable interests in shares in the company (other than redeemable shares) (item 1 of the table in subsection 152-70(1), and subsection 152-70(2) of the ITAA 1997).

15. If a company has more than one class of shares (other than redeemable shares), all classes must be taken into account in determining if the company has a significant individual. The fact that a shareholder holds 20% of one class of shares will not be sufficient if the directors have the discretion to make distributions of income or capital to any class of shares to the exclusion of the other classes of shares. Rather, a shareholder must be capable of receiving at least 20% of any distribution made regardless of how the directors exercise their discretion.

16. [Omitted.]

Note

17. As noted in the Treasurer's Press Release No. 38 of 2006 (9 May 2006), the Board of Taxation's report on its Post-Implementation Review of the small business CGT concessions contains a number of legislative recommendations. This Determination reflects amendments made by *Tax Laws Amendment (2006 Measures No. 7) Act 2007* that gave effect to those recommendations.

References

Previous draft:

TD 2006/D22

Related Rulings/Determinations:

TR 2006/10

Subject references:

- basic conditions for relief
- capital gains
- capital gains tax
- CGT small business relief
- significant individual
- significant individual test

Legislative references:

- ITAA 1997 152-55
- ITAA 1997 152-65
- ITAA 1997 152-70(1)
- Tax Laws Amendment (2006 Measures No. 7) Act 2007
- TAA 1953

Other references

- Treasurer's Press Release No. 38 of 2006

ATO references

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