# *TR 2004/7 - Income tax: capital gains: application of Division 149 of the Income Tax Assessment Act 1997 and Division 20 of Part IIIA of the Income Tax Assessment Act 1936 to public entities*

# Taxation Ruling

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



***Preamble***

*The number, subject heading, **What this Ruling is about** (including **Class of person/arrangement** section), **Date of effect**, and **Ruling** parts of this document are a 'public ruling' for the purposes of **Part IVAAA of the Taxation Administration Act 1953** and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

# 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 149 of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. In part, this Ruling considers the determinations that public entities were required to make under Division 149 for test days before 30 June 1999. This includes consideration of the statutory tracing concessions that can be relied on in making the determinations.

3. The Ruling also outlines matters that determine whether the Commissioner can be satisfied, or think it reasonable to assume, that the same ultimate owners held majority underlying interests in a public entity's assets. This advice in the Ruling is intended to assist public entities in the preparation of information for the Commissioner to consider where:

- the entity cannot make a positive determination that majority underlying interests in its assets had been maintained in respect of test days before 30 June 1999; or
- the entity must submit evidence of majority underlying interests held in its assets in respect of test days on and after 30 June 1999, in order for its CGT assets not to lose their pre-CGT status.

4. 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.

5. The Ruling does not deal with the application of Division 149 to interests held in an entity, directly or indirectly, through redeemable preference shares. The Tax Office plans to consult further on this issue.

6. The Ruling also does not deal with the tracing of underlying interests in an entity's pre-CGT assets where a family discretionary trust has shares, units or other interests in that entity. This issue will be considered on a case by case basis.

7. In this Ruling, a reference to certain provisions in Division 149 of the ITAA 1997 is also intended to include a reference to comparable provisions in Division 20 of Part IIIA of the *Income Tax Assessment Act 1936* (ITAA 1936). The table below sets out these references:

| **Reference to:** | **Includes a reference to:** |
|---|---|
| Division 149 | Division 20 |
| Subdivision 149-C | Subdivision C of Division 20 |
| Subdivision 149-D | Subdivision E of Division 20 |
| Subdivision 149-E | Subdivision F of Division 20 |
| Subdivision 149-F | Subdivision G of Division 20 |
| subsection 149-60(3) | subsection 160ZZSA(3) |
| subsection 149-70(3) | subsection 160ZZSC(2)<br>subsection 160ZZSD(2) |
| subsection 149-140 | section 160ZZSQ |

8. All subsequent legislative references are to the ITAA 1997, unless otherwise indicated.

**Key terms**

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

| Term in ITAA 1997 | Definition | Term in ITAA 1936 |
|---|---|---|
| majority underlying interests | subsection 149-15(1) | majority underlying interests |
| mutual affiliate company | section 121AC of the ITAA 1936 | mutual insurance organisation |
| mutual insurance company | section 121AB of the ITAA 1936 | 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 |

### Class of person/arrangement

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

### Background

11. Under Division 149 of the ITAA 1997, 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.

12. 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.

13. 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 149-70(3) (now repealed) that the majority underlying interests had been maintained or should be assumed to have been maintained.

14. 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.

15. Although there are guidelines in this Ruling for exercise of the Commissioner's power in subsection 149-60(1) 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.

# Date of effect

16. 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).

# Ruling

### Standard of evidence required

17. 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 149-70(3) may apply. Under this subsection, 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 it at the end of the starting day.

18. The Commissioner would be satisfied, or think it reasonable to make the necessary assumption, under subsection 149-70(3) if, having regard to all the information available, it is more likely 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.

19. 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. The Commissioner's decision must be based solely on the evidence provided.

20. The Commissioner is likely to be satisfied, or have reasonable grounds to assume, that majority underlying interests have been maintained since the public entity's starting day if, on the basis of all the information provided, it is more likely than not that those majority underlying interests have been maintained. Information relevant only to the tracing rules previously available under Subdivisions 149-D and 149-E is not taken into account for tests in respect of the test day on 30 June 1999 or any later test day.

### Reliance on the statutory tracing rules

21. For determinations in respect of 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 149-D, 149-E and 149-F.

22. Generally, in deciding whether there are sufficient grounds to be satisfied, or reasonably to assume, under subsection 149-70(3), that the majority underlying interests were held by the same ultimate owners, we accept the results of applying the tracing rules. The Commissioner would 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 Taxation Ruling TR 1999/4. The Commissioner would not require a public company or publicly traded unit trust to go behind the tracing rules by examining underlying interests further.

23. However, the Commissioner 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 life insurance companies

24. The tracing rule in Subdivision 149-E applies in relation to interests held by a 'mutual insurance company' as defined in subsection 121AB(1) of the ITAA 1936. This definition does not include mutual life insurance companies that do not carry on a life insurance business in Australia unless they are registered under the *Life Insurance Act 1995*. However, if mutual life insurance companies in a particular overseas country invest in shares or units for the same reasons as Australian mutual life 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.

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

- for what length of time, on average, the mutual life insurance companies hold the shares or units they purchase;
- for what purposes the mutual life insurance companies invest in shares or units;
- what proportion of members of the mutual life insurance companies continue to be members for long periods (for example, for more than ten years);
- whether some products offered by the mutual life 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 life insurance company sector in that country at any time since September 1985.

### Interests held through nominees; bearer shares

26. The tracing rule in Subdivision 149-D 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.

27. The benefit of the notional holder tracing rule is not available where interests of less than 1% are held by a nominee that holds, for all of its clients in aggregate, more than 1% of the shares or units. However, if a public company or publicly traded unit trust holds

shares in another public company or units in another publicly traded unit trust through a nominee, the presence of the nominee does not prevent the interposed company or interposed trust notional holder rule from applying.

28. In circumstances in which the notional holder rule is not available, 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 149-70(3).

29. 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.

**Separate notional holders; superannuation funds, government bodies, etc**

30. When applying the notional holder rule in Subdivision 149-D for tests in respect of a test day prior to 30 June 1999, 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.

31. 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 149 if the same notional holder is taken to have had underlying interests at the starting day.

32. 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 149-E for tests in respect of test days before 30 June 1999. The underlying interests represented by the shares or units it holds are only covered by this Subdivision 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

33. A public entity that has made an incorrect determination in respect of 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 149 or an extended time allowed by the Commissioner.

34. A public company or publicly traded unit trust may also make a new determination in lieu of an earlier determination made on a different basis. It may do this, for example, to make use of one of the statutory tracing rules 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 149.

### Extensions of time for determinations or to provide evidence

35. The Commissioner may extend the period for making a determination about majority underlying interests under subsection 160ZZSA(2) of the ITAA 1936 or subsection 149-55(1) (before it was amended). 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.

36. In deciding whether to allow extra time the Commissioner would have regard to matters including the circumstances that made it necessary to ask for extra time, what measures the entity has already taken and whether it will be able to demonstrate within a reasonable time that the majority underlying interests in its assets have been maintained. When requesting an extension of time, a public entity should provide details of all matters it considers relevant for the Commissioner to take into account.

37. If a public entity is requesting extra time to give evidence to the Commissioner under section 149-55, and the entity has all the required evidence available, it should provide the evidence together with the request for extra time. In cases where the entity has not obtained all the necessary evidence, or the law requires the entity to make a determination about the majority underlying interests in its assets, the Commissioner would decide how much extra time should be allowed in consultation with the person making the request.

### Subsidiaries wholly owned indirectly by public entities

38. Until 11 March 1999, when amendments to subsection 149-50(1) came into operation, certain subsidiary companies that were wholly owned by one or more public entities indirectly, through other wholly-owned subsidiaries, were not within Subdivision 149-C or Subdivision C of Division 20 in Part IIIA of the ITAA 1936. They were required to monitor changes in the underlying interests in their assets under Subdivision 149-B and previously under section 160ZZS of the ITAA 1936. The practical effect of Taxation Ruling IT 2530 was that these wholly-owned subsidiaries had no obligation to examine the underlying interests in their assets, if they were indirectly owned by one or more listed public companies or publicly traded unit trusts, so long as there were only normal transactions in the listed public company's shares or publicly traded unit trust's units which were not associated with takeover or merger activities.

39. Wholly-owned subsidiaries that became subject to Subdivision 149-C from 11 March 1999 following the amendment to the law may treat their pre-CGT assets in either of two ways. The first is to bring all of the pre-CGT assets within the capital gains provisions from a date before 11 March 1999, being the first date at which the parent entity or entities determined that the majority underlying interests in its/their assets had not been maintained. The subsidiary would only be entitled to choose this earlier date if, taking into account the result of the parent entity's determination or parent entities' determinations at this date, the majority underlying interests in the subsidiaries' assets have also changed.

40. The second way is to rely on Taxation Ruling IT 2530 (if there had been no abnormal trading in the parent listed public company's shares or publicly traded unit trust's units), preserving the pre-CGT status of the assets until the subsidiary's first test day on or after 11 March 1999. From this first test day after 11 March 1999, Taxation Ruling IT 2530 is no longer relevant to the subsidiaries and the provisions of Subdivision 149-C apply.

41. The wholly-owned subsidiary may exercise the choice between the options in paragraphs 39 and 40 retrospectively after this Ruling is issued.

# Explanation

### Standard of evidence required

#### *For test days before 30 June 1999*

42. Paragraphs 31 to 43 of Taxation Ruling TR 1999/4 discuss a number of matters that are commonly relevant to an exercise of the Commissioner's power under subsection 149-70(3) (that is, 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.

43. 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.

44. The power in subsection 149-70(3) is exercised in a public entity's favour if, having regard to all the information available, it is more likely 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. **Example 1** at paragraph 86 of this Ruling provides an illustration.

### *For test days on and after 30 June 1999*

45. For tests in respect of test days on and after 30 June 1999, the tracing rules in Subdivisions 149-D and 149-E no longer apply and the types of information that public entities may rely on change accordingly.

46. The onus is on a public entity to 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 Commissioner must decide whether, based on the information supplied, it is more likely 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.

47. The law continues to allow some flexibility to the Commissioner in taking into consideration a variety of evidence. As was the case in respect of test days before 30 June 1999, the Commissioner may take account of relevant information of any kind, whether or not it is evidence specifically about underlying interests in an entity's pre-CGT assets. Public entities providing written evidence to the Commissioner should consider including any information of a more general kind (such as statistical information) that may assist in satisfying the Commissioner, or making it reasonable to assume, that the majority underlying interests in pre-CGT assets were held by the same ultimate owners at the entity's starting day and at the test day.

### Reliance on the statutory tracing rules

48. When making a determination about majority underlying interests in respect of test days before 30 June 1999, a public company or a publicly traded unit trust may use the tracing rules in Subdivisions 149-D, 149-E and 149-F in the ITAA 1997. This raises the question 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 149-70(3).

49. 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, the Commissioner 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, the Commissioner would 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.

50. However, the Commissioner 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 life insurance companies

51. Among the classes of entities covered by the tracing rule in Subdivision 149-E are mutual insurance companies as defined in subsection 121AB(1) of the ITAA 1936. 'Mutual insurance company' includes a mutual life insurance company registered under the *Life Insurance Act 1995*. However, overseas mutual life insurance companies that do not carry on a life insurance business in Australia and are not registered under the *Life Insurance Act 1995* are not mutual insurance companies for the purposes of the *Income Tax Assessment Acts*.

52. As a result, the tracing rule in Subdivision 149-E for interests held by mutual insurance companies does not apply to mutual life insurance companies that are not carrying on business in 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 life insurance company, the Australian company generally cannot use the tracing rule for the interests held by the overseas mutual life insurance company.

53. We recognise that there may be mutual life insurance companies in other countries that invest in shares or units for the same reasons as Australian mutual life insurance companies, hold shares or units as long-term investments and whose members also remain members for long periods. If the Commissioner is satisfied that the mutual life insurance companies in a particular overseas country share these features of Australian mutual life 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 life insurance company. An assumption on this basis would only be made for a test day before 30 June 1999.

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

- for what length of time, on average, the mutual life insurance companies hold the shares or units they purchase;
- for what purposes the mutual life insurance companies invest in shares or units;
- what proportion of members of the mutual life insurance companies continue to be members for long periods (for example, for more than ten years);
- whether some products offered by the mutual life 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 life insurance company sector in that country at any time since September 1985.

**Interests held through nominees**

55. 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.

56. A view of the law has been put to us, based on section 106-50 (previously subsection 160V(1) of the ITAA 1936), that would result in the notional holder rule applying to interests held through nominee companies. According to this argument, the effect of section 106-50 is that persons who have interests in a public company's shares or a publicly traded unit trust's units through a nominee are treated as the owners of the shares or units for the purposes of the capital gains provisions. It is also argued that the nominee's action in seeking to

have its legal ownership of the shares or units registered is to be regarded as the act of the beneficial owner. The conclusion, therefore, is that the beneficial owners are to be treated as registered owners in applying the notional holder rule and the nominee's legal interest is to be disregarded.

57. We do not agree with this view. Sections 149-110 and 149-115 of the ITAA 1997 (now repealed) set out the conditions for application of the notional holder rule. In the case of a company there must have been 'dividend shareholdings of less than 1%' or 'capital shareholdings of less than 1%' in the company. In the case of a publicly traded unit trust there must have been 'income unitholdings of less than 1%' or capital unitholdings of less than 1%' in the trust. These defined terms are used, as far as the capital gains provisions of the Act are concerned, only in relation to the examination of underlying interests in an entity's pre-CGT assets.

58. Each of these defined terms has a similar definition. 'Dividend shareholding of less than 1%', for example, is defined in subsection 166-240(2):

> (2) If all the *shares in a company of which an entity is the registered holder at a particular time carry (between them) the right to receive less than 1% of any *dividends that the company may pay, those shares (except shares that are *part of a substantial shareholding) constitute a ***dividend shareholding of less than 1%*** in the company at that time.

59. A feature of the definition, and of each of the other definitions, is that it refers to shares (or units) of which an entity is the registered holder. This use of the concept of registered membership is also unique, in the capital gains provisions, to the tracing rules for underlying interests in Division 149.

60. There is no reason to assume that 'registered holder' was intended to have the same meaning as 'owner', 'legal owner' or 'beneficial owner', the terms used in the capital gains provisions dealing with acquisition of assets and CGT events. It can more readily be inferred that, used in the different context of identifying changes in underlying interests, 'registered holder' was chosen to express a concept different from ownership. A 'registered holder' of shares or units is the person or entity shown on the company's or trust's official register as being entitled to exercise rights in relation to those shares or units. It is a narrower concept than 'shareholder' which also covers a person who is registered, or entitled to be registered, as a member of the company or trust (see *Patcorp Investments Ltd v. Federal Commissioner of Taxation* (1976) 140 CLR 247; 76 ATC 4225; 6 ATR 420). The registered holder may or may not be either the person legally entitled to, or the beneficial owner of, the shares or units at any relevant time.

61. It is not appropriate to extend a provision such as section 106-50, which deals with legal and beneficial ownership in the context of acquisition of assets and CGT events, to the different concept of

registered interests as used in the provisions dealing with underlying interests. Besides not being relevant to the notional holder tracing rule as a matter of statutory interpretation, section 106-50 would give the notional holder rule an unintended effect. It would cause the rule to apply to interests of less than 1% in a public company or publicly traded unit trust that are held through a nominee. This would be inconsistent with the intention expressed in paragraph 6.109 of the Senate Explanatory Memorandum to Taxation Laws Amendment Bill (No 1) 1997, which states: 'In circumstances where the interposed entity holds shares or units other than in its own right, such as a nominee, the notional holder rule would have no effect'.

62. The view we take does not prevent the notional holder rule from operating where a public company or publicly traded unit trust holds shares or units through a nominee in another public company or publicly traded unit trust. See **Examples 2** and **3** at paragraphs 88 to 91.

### Bearer shares

63. 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.

64. 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 149-60(3) requires the companies to assume that those underlying interests in their assets have changed.

65. 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 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.

66. When considering an application under subsection 149-70(3), or written evidence given to the Commissioner under subsection 149-55(1), the Commissioner would apply the same standards to companies with bearer shares as for 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 the Commissioner, or furnish reasonable grounds to assume, that the majority underlying interests have not changed. Any kind of evidence that might assist the Commissioner 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.

### Separate notional holders

67. For tests in respect of test days before 30 June 1999, the notional holder rule in 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.

68. 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 149 if that same notional holder is taken to have had underlying interests at the starting day. **Example 4** at paragraph 92 of this Ruling gives an illustration.

### Superannuation funds, government bodies, etc

69. A similar principle applies for the tracing rule in 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. The tracing rule is only available for tests in respect of test days before 30 June 1999.

70. 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

71. In some circumstances a public entity that has made a determination about majority underlying interests under 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 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 because it assumed that the Commissioner would exercise the power in section 149-140. With the repeal of 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.

72. If a public entity discovers that it relied on incorrect records or unauthorised assumptions to make its determination, it may make a new determination. The new determination must be made within the time allowed for making that determination under Division 149 or an extended time allowed by the Commissioner.

73. A public company or publicly traded unit trust that has made a 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 purported to make 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 149.

### Extensions of time for determinations or to provide evidence

74. Public entities may request an extension of time for the purposes of Division 149 in a number of circumstances. A public entity required to make a determination or provide written evidence

about the majority underlying interests in its assets may not have made a determination or provided the evidence within the time allowed. Alternatively, if the public entity originally determined that the same ultimate owners had not had the majority underlying interests since its starting day, it may wish to change the determination. Again, a public entity which originally determined that the majority underlying interests in its assets had been held by the same ultimate owners may have since discovered that its determination was incorrect.

75. The following matters are usually relevant to deciding whether extra time should be allowed in all of these circumstances:

- the reasons why the entity was unable to make a determination, or a determination on a new basis, or provide written evidence within the period specified in the law or within any further period allowed by the Commissioner;
- in the case of a request for extra time to make a determination – whether the entity had reason to believe that its determination might be affected by *Taxation Laws Amendment Act (No. 4) 1999* or by Taxation Ruling TR 1999/4 or this Ruling;
- whether the entity has made all reasonable efforts to obtain the information necessary to make a determination or new determination, or to provide written evidence to the Commissioner;
- whether the entity's request for an extension of time was made as soon as the need for more time became apparent;
- if the entity needs to obtain further information before making a determination or providing written evidence – whether there is reason to believe all outstanding information will be obtained within a reasonable time if extra time is allowed; and
- whether it is likely that, at the end of the extended period, the entity will have sufficient grounds to determine, or the Commissioner will have grounds to be satisfied or reasonably to assume, that the majority underlying interests in the entity's assets have been maintained.

76. Certain considerations in paragraph 75 do not apply in particular cases. For example, if a public entity has previously determined that the same ultimate owners have maintained the majority underlying interests in its assets, but wishes to change that determination, the last of the matters for consideration is not relevant. Apart from matters that do not apply in its particular circumstances, a public entity can assist by addressing each matter in paragraph 75 when it lodges a request for an extension of time.

77. Other matters may also be relevant to a public entity's case and these should also be raised by the entity in its written request. For example, the number of overseas companies that the entity is required to trace through, or the complexity of its holding structure.

78. The decision of whether to allow an extension of time is made after considering each relevant matter in paragraph 75 and all other relevant considerations. However, it is generally expected that further time will be allowed where an entity provides a reasonable explanation for not complying within the required timeframe.

79. Once a decision has been made to allow extra time, the Commissioner determines the appropriate length of time in consultation with the person who lodged the request. Public entities can also assist with this question by outlining in their request what further work has to be done before a determination can be made or before written evidence can be given to the Commissioner. An estimate of the time required to complete the work is also helpful.

### Subsidiaries wholly owned indirectly by public entities

80. *Taxation Laws Amendment Act (No. 4) 1999* changed the law by bringing all wholly-owned subsidiaries of one or more public entities, including both directly and indirectly-owned subsidiaries, within Subdivision 149-C. This ensures that public entities and all of their wholly-owned subsidiaries are required to examine their records for changes in majority underlying interests on the same test days. The change took effect from 11 March 1999.

81. Until the change, certain subsidiaries that were wholly owned by one or more public entities indirectly, through other wholly-owned subsidiaries, were not within Subdivision 149-C or Subdivision C of Division 20 in Part IIIA of the ITAA 1936. They were required to monitor changes in the underlying interests in their assets under Subdivision 149-B and previously under section 160ZZS of the ITAA 1936. They could also rely on paragraph 9 of Taxation Ruling IT 2530, which allowed subsidiaries wholly owned by listed public companies and publicly traded unit trusts, and entities partly owned by listed public companies and publicly traded unit trusts, to assume that the public companies and trusts had maintained continuity of majority underlying interests if there had only been normal transactions in their shares or units which were not associated with takeover or merger activities.

82. In some company groups it may have been convenient for wholly-owned subsidiaries that were not covered by Subdivision 149-C before 11 March 1999 to adopt their parent entity's determination about majority underlying interests from the time the determination was first made. For example, a listed public company that is the holding company for a group may have determined as at 20 January 1997 that the majority underlying interests in its assets had not been maintained.

83. One option for the group is to bring all pre-CGT assets owned by the wholly-owned subsidiaries within the capital gains provisions and obtain all market valuations as at 20 January 1997, even though some of the subsidiaries were indirectly-owned companies not covered by Subdivision C of Division 20 and could have relied on paragraph 9 of Taxation Ruling IT 2530.

84. Alternatively, the group may choose to rely on IT 2530 (if there had been no abnormal trading in the listed public company's shares), preserving the pre-CGT status of assets in some indirectly-owned entities that were not covered by Subdivision C of Division 20.

85. Each wholly-owned subsidiary in the company group is entitled to choose between these two options, if the subsidiary was not covered by Subdivision C of Division 20 or Subdivision 149-C before 11 March 1999. The choice may be exercised retrospectively after this Ruling is issued. If a particular subsidiary company has chosen to rely on paragraph 9 of Taxation Ruling IT 2530 and became subject to Subdivision 149-C from 11 March 1999, it is required to examine the underlying interests in its pre-CGT assets at its first test day on or after 11 March 1999 taking into account the results of each parent entity's most recent tracing of underlying interests.

# Examples

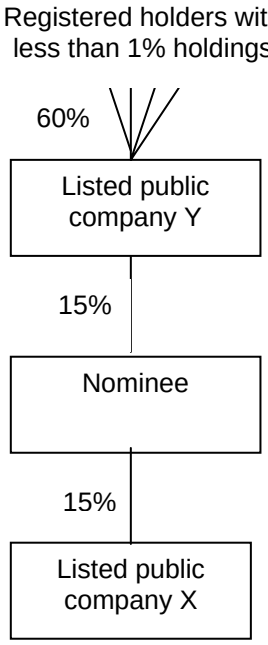
### Example 1: standard of evidence

86. AB Ltd, a listed public company, in using the tracing rules available under Division 149, has been able to demonstrate in respect of a test day before 30 June 1999 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.

87. 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 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. It could be expected that the power in subsection 149-70(3) may be exercised in this case.

**Example 2: interests held through nominees**

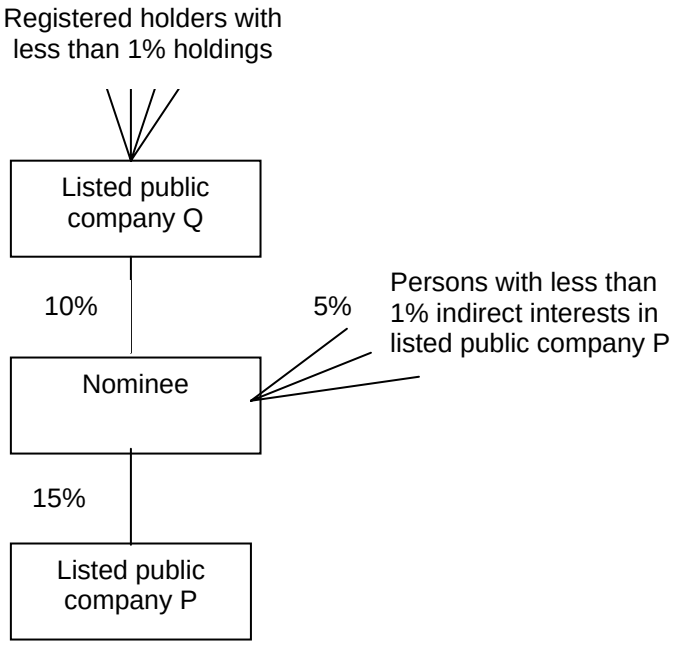
88. Listed public company Y has maintained a 15% interest in listed public company X since X's starting day. Registered holders with interests of less than 1% held 60% of the shares in Y at that starting day and at the test day.




89. If Y had held its 15% interest in X directly, X would have been entitled to make its determination about majority underlying interests on the basis that Y's notional holder held 9% (that is, 15% × 60%) of the underlying interests in X's assets at both times (see subsection 149-125(1)). Y's decision to hold its interests in X through a nominee does not change this. Y is still an interposed company as referred to in subsection 149-125(1) and its notional holder is taken to have a 9% underlying interest in X's assets.

**Example 3: interests held through nominees**

90. This example shows that a listed public company or publicly traded unit trust cannot disregard interposed nominees when applying the notional holder rule in subsection 149-120(1).




91. The notional holder rule is not available for the 5% of listed public company P's shares held through the nominee by persons with less than 1% interests. However, the interposed company notional holder rule in subsection 149-125(1) applies to the interests held indirectly in P's assets by listed public company Q's registered holders who have less than 1% interests in Q.

**Example 4: notional holder tracing rule**

92. 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 65%.

93. If new company GH chooses to use the notional holder rule for tests in respect of a test day before 30 June 1999, there are two relevant notional holders: GH's notional holder and (because EF Ltd still holds shares in GH) EF's notional holder. Suppose 25% 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 25%. This 25% 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 25% notional holder interest must be disregarded under Division 149.

94. 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 starting day and the 60% interest at the test day. EF's notional holder therefore has an interest of 32.5% (that is, 50% of 65%) at the test day in the rolled-over pre-CGT assets, now held by GH. This 32.5% notional holder interest may be taken into account in GH's determination under Division 149.

95. Note that if GH had existed and held the pre-CGT assets at the starting day, and had a notional holder interest of its own of 10%, this 10% would be added to EF's notional holder interest (assume still 32.5%) to determine the aggregate interest held by the notional holders in GH's assets (42.5%).

# Detailed contents list

96. Below is a detailed contents list for this Taxation Ruling:

**Commissioner of Taxation**
23 June 2004

*Previous draft:*
TR 1999/D9

*Related Rulings/Determinations:*
TR 92/1; TR 92/20; TR 97/16; TR 1999/4; IT 2530

*Subject references:*
- approved deposit fund
- base time
- bearer shares
- capital gains
- continuity of majority underlying interests
- determination
- discretion
- extensions of time
- 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
- 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:*
- ITAA 1936 121AB
- ITAA 1936 121AB(1)
- ITAA 1936 121AC
- ITAA 1936 160V(1)
- ITAA 1936 Pt IIIA Div 20
- ITAA 1936 160ZZS
- ITAA 1936 Pt IIIA Div 20 Subdiv C
- ITAA 1936 160ZZSA(2)
- ITAA 1936 160ZZSA(3)
- ITAA 1936 160ZZSC(2)
- ITAA 1936 160ZZSD(2)
- ITAA 1936 Pt IIIA Div 20 Subdiv E
- ITAA 1936 160ZZSQ
- ITAA 1936 Pt IIIA Div 20 Subdiv F

- ITAA 1936 Pt IIIA Div 20 Subdiv G
- ITAA 1997 106-50
- ITAA 1997 Div 149
- ITAA 1997 149-15(1)
- ITAA 1997 149-15(2)
- ITAA 1997 149-15(3)
- ITAA 1997 Subdiv 149-B
- ITAA 1997 Subdiv 149-C
- ITAA 1997 149-50(1)
- ITAA 1997 149-50(2)
- ITAA 1997 149-55
- ITAA 1997 149-55(1)
- ITAA 1997 149-55(2)
- ITAA 1997 149-60
- ITAA 1997 149-60(1)
- ITAA 1997 149-60(3)
- ITAA 1997 149-70(3)
- ITAA 1997 Subdiv 149-D
- ITAA 1997 149-110
- ITAA 1997 149-115
- ITAA 1997 149-120(1)
- ITAA 1997 149-125(1)
- ITAA 1997 149-140
- ITAA 1997 Subdiv 149-E
- ITAA 1997 Subdiv 149-F
- ITAA 1997 166-240(2)
- TAA 1953 Pt IVAAA
- Life Insurance Act 1995
- Taxation Laws Amendment Act (No 4) 1999

*Case references:*

- Patcorp Investments Ltd v. Federal Commissioner of Taxation (1976) 140 CLR 247; 76 ATC 4225; 6 ATR 420

*Other references:*

- Explanatory Memorandum to the Taxation Laws Amendment Bill (No 1) 1997

ATO references
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