



CR 2003/81W - Income tax: exchange of shares in Connect Credit Union of Tasmania Limited for ordinary shares in Connect Group Limited

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Class Ruling

Income tax: exchange of shares in Connect Credit Union of Tasmania Limited for ordinary shares in Connect Group Limited

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **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 Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- sections 45B and 45C of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- sections 124-360, 124-365 and 124-380 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies to, is the members of Connect Credit Union of Tasmania Limited (Connect) who will exchange their shares in the company for ordinary shares in Connect Group Limited (CGL). The share exchange is described in the **Arrangement** part of the Ruling.

Qualifications

4. The Commissioner makes this Ruling on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 19.
6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- (b) this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 14 August 2003. 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).

Withdrawal

9. This Class Ruling is withdrawn and ceases to have effect after 30 June 2004. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- the application for Class Ruling from Clayton Utz on behalf of Connect dated 30 June 2003; and
- the Constitution of Connect.

11. Connect is a public company limited by shares under the *Corporations Act 2001* (CA 2001) but is a private company under subsection 103A(1) of the ITAA 1936.

12. Connect is a head company of a consolidated group for income tax purposes.

13. The only shares on issue in Connect are member shares that have a subscription price and redemption value of \$10. There are approximately 59,000 member shares on issue. Each member of Connect is only entitled to hold one member share. The member shares are not transferable, carry no right to dividends, carry a right to one vote and entitle the member to a share of any surplus on winding up of Connect.

14. Connect wishes to re-organise its affairs to enable it to raise capital and create a holding company structure in order to prepare for listing on the Australian Stock Exchange. In order to do so, it must demutualise and issue ordinary shares. Connect will do this by a Scheme of Arrangement under Part 5.1 of the CA 2001.

15. Under the Scheme of Arrangement Connect will incorporate a new Australian-resident company, Connect Group Limited (CGL). CGL will issue up to five ordinary shares to a director of Connect who will hold the shares on behalf of Connect.

16. Connect will amend its Constitution to allow member shares to be transferred under the Scheme of Arrangement to CGL in exchange for new ordinary shares in CGL. By operation of the CA 2001 and the passing of a company resolution, the member shares are taken to be redeemable preference shares.

17. All Connect members will transfer their member shares to CGL in exchange for CGL issuing ordinary shares to the members. Each member will receive the same number of CGL ordinary shares. Upon issue of the CGL ordinary shares CGL will credit its capital account for the fair value of the Connect shares.

18. CGL will elect to continue the consolidated group of which Connect was formerly the head company, as the head company.

19. This arrangement is subject to approval by the members of Connect.

Ruling

Replacement asset rollover

20. Australian resident members of Connect will be taken to have chosen to obtain replacement asset rollover in relation to their exchange of member shares in Connect for ordinary shares in CGL.

Capital Benefit

21. The Commissioner will not make a determination (under section 45B of the ITAA 1936) that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefit received by the Connect members.

Explanation

Replacement asset rollover

22. The arrangement described in this Ruling relates to the disposal of shares in one company in exchange for shares in another company. A share in a company is a CGT asset (Section 108-5 of the ITAA 1997) and its disposal would be a CGT event A1, resulting in a calculation of a capital gain or capital loss.

23. However, in certain circumstances the capital gains tax legislation, such as Division 124 of the ITAA 1997, permits a deferral ('rollover') to the recognition of a capital gain or capital loss. This Division specifically deals with replacement asset rollover.

24. Subdivision 124-G of the ITAA 1997 broadly allows for rollover where there is a reorganisation of a company such that shareholders exchange their shares in one company for shares in another company. The arrangement involves a disposal case, where each Connect member will exchange their share in Connect for ordinary shares in CGL.

25. The requirements for rollover that need to be satisfied for disposal cases are set out in sections 124-360, 124-365 and 124-380 of the ITAA 1997.

Requirements under subsection 124-360(1) of the ITAA 1997

26. The first two requirements of section 124-360(1) of the ITAA 1997 will be satisfied as Connect is a company with a number of members.

27. The third requirement in subsection 124-360(1) of the ITAA 1997 is that there must be 'a scheme for reorganising its affairs'. What is meant by this expression is the interposition of a company between the existing company and its shareholders (see paragraphs 26 and 31 of the Taxation Ruling TR 97/18). As CGL is being interposed between Connect and its members there will be a scheme for reorganising Connect's affairs.

28. The fourth requirement in subsection 124-360(1) of the ITAA 1997 is that sections 124-365 and 124-380 of the ITAA 1997 must be satisfied.

Requirements under section 124-365 of the ITAA 1997

29. The requirement in section 124-365 of the ITAA 1997 will be met as after the exchange in shares (the completion time):

- (a) CGL will own all the shares in Connect (see subsection 124-365(1) of the ITAA 1997);
- (b) each member of Connect will receive a whole number of CGL ordinary shares and will hold the same percentage of shares in CGL as they held in Connect (see subsection 124-365(2) of the ITAA 1997);
- (c) the ratio of:
 - (i) the market value of each Connect member's ordinary shares in CGL to the market value of the ordinary shares in CGL issued to all the Connect members (worked out just after the completion time); will equal the ratio of:
 - (ii) the market value of that Connect member's share in Connect that was disposed of to CGL to the market value of all the shares in Connect that were disposed of to CGL (worked out just before the first disposal) (see subsection 124-365(3) of the ITAA 1997); and

- (d) the residency status of Connect members is not a relevant issue as non residents are not excluded from obtaining rollover under this section because shares in Connect, being a private company, have the 'necessary connection with Australia' (paragraph 124-365(4)(b) of the ITAA 1997).

Requirements under section 124-380 of the ITAA 1997

30. The requirement in subsection 124-380 of the ITAA 1997 will be met, as:

- (a) The shares to be issued by CGL will be ordinary shares (see subsection 124-380(1) of the ITAA 1997);
- (b) Connect members will hold CGL ordinary shares until after the completion time (see subsection 124-380(2) of the ITAA 1997);
- (c) Connect members will own all the ordinary shares in CGL other than the five ordinary shares issued to a director of Connect. The market value of those five shares expressed as a percentage of the market value of all the ordinary shares in CGL is such that it is reasonable to treat Connect members as owning all the ordinary shares (see paragraph 124-380(3)(b) of the ITAA 1997);
- (d) Connect and CGL will be Australian resident companies (see subsection 124-380(4) of the ITAA 1997); and
- (e) Connect will be the head company of a consolidated group immediately prior to the share exchange. After the completion time CGL will be the head company of the consolidated group. CGL will choose, within 2 months after the completion time that the consolidated group will continue in existence at and after the completion time (see subsections 124-380(5) and 124-380(7) of the ITAA 1997).

Subsection 124-360(2) of the ITAA 1997

31. Subsection 124-360(1) of the ITAA 1997 allows a shareholder to choose to obtain the rollover if the relevant requirements are met. However, under subsection 124-360(2) of the ITAA 1997 where the original company is the head of a consolidated group immediately before the completion time and immediately after the completion time

the interposed company is the head of the group, then the shareholder is taken to have chosen to obtain the rollover.

32. Therefore, members of Connect will be taken to have chosen the rollover in relation to this arrangement.

The Capital Benefit not made in substitution of a Dividend

33. The purpose of section 45B of the ITAA 1936 is to treat payments, allocations or distributions made in substitution for dividends as dividends (see subsection 45B(1) of the ITAA 1936).

34. Subsection 45B(2) of the ITAA 1936 defines the application of this section. This section applies if:

- (a) there is a scheme under which a person is provided with a capital benefit by a company;
- (b) under the scheme, a taxpayer (the relevant taxpayer), who may or may not be the person provided with the capital benefit, obtains a tax benefit; and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling a taxpayer (the relevant taxpayer) to obtain a tax benefit.

Arrangement is a 'Scheme'

35. The term 'scheme' in Part IIIAA of the ITAA 1936 is broadly defined by section 177A of the ITAA 1936:

- (a) 'any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- (b) any scheme, plan, proposal, action, course of action or course of conduct.'

36. The arrangement described in this Ruling which involves members of Connect approving the exchange of Connect shares for CGL ordinary shares will constitute a scheme.

A Person 'Provided with a Capital Benefit'

37. A reference to a person being provided with a capital benefit is defined in subsection 45B(5) of the ITAA 1936 to include the provision of ownership interests in a company.

38. An ownership interest in a company means a share in the company or an option, right or similar interest issued by the company that gives the owner an entitlement to acquire a share in the company (see paragraph 125-60(1)(a) of the ITAA 1997). The issue of ordinary shares in CGL will constitute a provision of ownership interests in a company.

39. Therefore, members of Connect will each receive a capital benefit.

A Person Obtains a 'Tax Benefit'

40. The meaning of tax benefit is defined in section 45B(9) of the ITAA 1936:

‘A relevant taxpayer obtains a tax benefit if an amount of tax payable, or any other amount payable under this Act, by the relevant taxpayer would, apart from this section, be less than the amount that would have been payable, or would be payable at a later time than it would have been payable, if...the capital benefit had been a dividend.’

41. Connect members will obtain tax benefits when they are deemed to have chosen to obtain rollover under subsection 124-360(2) of the ITAA 1997.

With Regards to 'Relevant Circumstances of Scheme'

42. The nature of paragraph (c) of subsection 45B(2) of the ITAA 1936 is more complex than the other requirements in this section. It requires a person or persons to enter into the scheme for the purpose of a ‘taxpayer’ obtaining a tax benefit. It is necessary to consider the ‘relevant circumstances of scheme’ to determine the purpose of the scheme. Section 45B(2) of the ITAA 1936 will not apply if seeking the tax benefit will be only incidental to the purpose of entering or carrying out the scheme or part of. The meaning of ‘relevant circumstances of scheme’ is defined in section 45B(8) of the ITAA 1936.

43. Having regard to the relevant circumstances of the arrangement it is concluded that the persons involved in this scheme, Connect, CGL and Connect members, have not entered into or carried out the scheme for the purpose of obtaining tax benefits for Connect members. The form of the scheme is not different from the substance

of the scheme. The purpose of the arrangement is to re-organise Connect's affairs to enable it to raise capital and create a holding company structure in order to prepare it for listing on the Australian Stock Exchange and to allow flexibility in expanding Connect's business. Whilst the arrangement may have the effect of providing capital benefits to Connect members, any tax benefit that may be obtained by Connect members is only incidental.

44. In this regard, it cannot be said that the return of capital is attributable to the profits of the company, nor do the pattern of distributions indicate that it is being paid in substitution for a dividend. The conclusion that the distribution is demonstrably not attributable to profits of Connect or an associate of Connect follows from the fact that the ordinary shares in CGL are being issued in exchange for the Connect member shares.

45. Therefore, paragraph 45B(2)(c) of the ITAA 1936 is not satisfied, and section 45B does not apply to this scheme.

Detailed contents list

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Commissioner of Taxation

 24 September 2003

<i>Previous draft:</i>	- ITAA 1936 45B(9)
Not previously issued as a draft	- ITAA 1936 45C
	- ITAA 1936 103A(1)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 177A
TR 92/1; TR 92/20; TR 97/16;	- ITAA 1997 108-5
TR 97/18; CR 2001/1	- ITAA 1997 124
	- ITAA 1997 124-G
<i>Subject references:</i>	- ITAA 1997 124-360
- capital benefit	- ITAA 1997 124-360(1)
- credit unions	- ITAA 1997 124-360(2)
- dividends	- ITAA 1997 124-365
- exchange of shares in one company	- ITAA 1997 124-365(1)
for shares another company	- ITAA 1997 124-365(2)
- private company	- ITAA 1997 124-365(3)
- replacement asset rollover	- ITAA 1997 124-365(4)(b)
	- ITAA 1997 124-380
	- ITAA 1997 124-380(1)
<i>Legislative references:</i>	- ITAA 1997 124-380(2)
- ITAA 1936 IIIAA	- ITAA 1997 124-380(3)(b)
- ITAA 1936 45B	- ITAA 1997 124-380(4)
- ITAA 1936 45B(1)	- ITAA 1997 124-380(5)
- ITAA 1936 45B(2)	- ITAA 1997 124-380(7)
- ITAA 1936 45B(2)(a)	- ITAA 1997 125-60(1)(a)
- ITAA 1936 45B(2)(b)	- Copyright Act 1968
- ITAA 1936 45B(2)(c)	- Corporations Act 2001
- ITAA 1936 45B(5)	- TAA 1953 Part IVAAA
- ITAA 1936 45B(8)	

ATO references

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