

# ***CR 2004/119 - Income tax: conversion of shares and variation in rights: Golden Circle Limited***



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## Class Ruling

### Income tax: conversion of shares and variation in rights: Golden Circle Limited

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Contents	Para
<b>What this Class Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>7</b>
<b>Arrangement</b>	<b>8</b>
<b>Ruling</b>	<b>16</b>
<b>Explanation</b>	<b>23</b>
<b>Detailed contents list</b>	<b>51</b>

#### **Preamble**

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **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

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1. This Ruling sets out the Commissioner's opinion on the way in which the tax laws identified below apply to the class of persons identified in paragraph 3.

#### **Tax law(s)**

2. The tax laws are the following provisions of the *Income Tax Assessment Act 1997* (ITAA 1997):

- section 6-5;
- section 6-10;
- section 104-10 (CGT event A1);
- section 104-25 (CGT event C2);
- section 104-35 (CGT event D1);
- section 104-155 (CGT event H2);
- section 112-25;
- section 116-20;
- section 130-20;
- section 725-50;
- section 725-55;
- Subdivision 727-E; and
- section 727-355.

## Class of persons

3. The class of persons are the holders of A Class shares and the holders of B Class shares in Golden Circle Limited (GCL) who:
- (a) have their GCL shares converted to ordinary shares under the arrangement described in paragraphs 8 to 15; and
  - (b) hold those shares on capital account.

## Qualifications

4. Those persons may rely on this Ruling provided the arrangement actually carried out is the arrangement described in paragraphs 8 to 15.
5. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:
- 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
  - this Ruling may be withdrawn or modified.
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## Date of effect

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7. This Ruling applies to an income year that includes the date of the passing of the ordinary resolution to convert GCL shares. The resolution will be passed on or before 30 June 2005.

## Arrangement

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8. The arrangement that is the subject of the Ruling is described below. The description is based on the following documents which are incorporated into and form part of the description:
- Class Ruling request from PricewaterhouseCoopers dated 10 September 2004;

- Constitution of GCL;
- Draft ordinary resolutions for the conversion of GCL share capital;
- Draft special resolutions for amendment of GCL constitution; and
- GCL media releases dated 27 February 2004 and 14 May 2004.

**Note:** Certain information received from GCL and PricewaterhouseCoopers has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information Legislation.

### **Share capital of GCL**

9. GCL is a company limited by shares. GCL shares are traded on a stock market operating under an Australian Market Licence issued under the *Corporations Act 2001* (Corporations Act). This means GCL shares can be traded but only by growers who are eligible to be GCL shareholders under the GCL Constitution.

10. GCL has two classes of shares on issue – A Class shares and B Class shares. Each A Class share carries 3.33 times the voting, dividend, and capital rights carried by each B Class share. Under the GCL Constitution, the maximum shareholding for any one shareholder is 10% of issued share capital, and no shareholder can exercise voting rights (by proxy or otherwise) in respect of more than 15% of the issued share capital of the company.

### **Conversion of shares and modifications to the GCL Constitution**

11. GCL will convert the A Class shares and B Class shares into a larger number of shares and vary the rights attaching to the A Class shares. As a result, the company's issued share capital will become a single class (called ordinary shares) with each share having exactly the same voting, dividend and capital rights.

12. The arrangement, as it relates to the holders of A Class shares, has the following features:

- the conversion, on the passing of a resolution under section 254H of the *Corporations Act 2001*, of each original A Class share into 33.3 shares (a conversion ratio of 33.3);
- the issue to a shareholder that holds a fraction of a share following the conversion of an additional fraction of a share to round their shareholding up to the next whole number;

- the removal of the clauses in the GCL Constitution that confer on the holders of A Class shares 3.33 times the voting, dividend and capital rights than the B Class shareholders; and
- the amendment of the GCL constitution to rename A Class shares ordinary shares.

13. The arrangement, as it relates to the holders of B Class shares, has the following features:

- the conversion, on the passing of a resolution under section 254H of the *Corporations Act 2001*, of each original B Class share into 10 shares (a conversion ratio of 10); and
- the amendment of the GCL Constitution to rename B Class shares ordinary shares.

14. The GCL Constitution will also be amended to increase the maximum shareholding and voting rights percentages to 49%.

15. The arrangement is subject to shareholder approval (by ordinary and special resolution). The variation of share rights will only occur if the resolution to convert the shares is passed. If the resolutions are passed, the conversion and variation will occur simultaneously.

## Ruling

16. The conversion of the A Class and B Class shares will not result in any CGT event in Division 104 of the ITAA 1997 happening (subsections 112-25(1) and (2) of the ITAA 1997). The converted shares will have:

- (a) the same acquisition date as the original shares to which they relate; and
- (b) a cost base and reduced cost base that is based on a reasonable apportionment of the cost base and reduced cost base of the original shares to which they relate: subsections 112-25(2) and (3) of the ITAA 1997.

17. The variation of the rights attaching to the A Class shares will cause CGT event H2 to happen in respect of those shares. However, no shareholder will make a capital gain as a result of the event happening because they will not receive capital proceeds. The acquisition date of the A Class shares will not be affected by CGT event H2 happening. No other CGT event in Division 104 of the ITAA 1997 will happen as a result of the variation.

18. No CGT event in Division 104 of the ITAA 1997 will happen as a result of the renaming of A and B Class shares as ordinary shares, or the increase of the maximum shareholding and voting rights percentages to 49%.

19. The conversion of shares and the variation of rights will not result in any assessable income being derived by any shareholder under section 6-5 of the ITAA 1997 (about ordinary income) or section 6-10 of the ITAA 1997 (about statutory income).

20. The issue of a fraction of a share to a shareholder to round up their shareholding to the nearest whole number following the conversion is a bonus equity: subsection 130-20(1) of the ITAA 1997. No part of the bonus equity is a dividend.

21. The conversion of shares, variation of share rights and issue of fractional shares will not have any direct value shifting consequences for GCL shareholders because section 725-50 of the ITAA 1997 is not satisfied.

22. The arrangement the subject of this Ruling is an entirely separate arrangement, and is in no way connected, to the arrangement considered in Class Ruling CR 2001/26. Therefore, nothing considered in this Ruling has any bearing on, or in any way changes, the conclusions reached in CR 2001/26.

## **Explanation**

### **CGT: share conversion**

23. The share conversion involves the splitting of each share into a number of new shares on the basis of the relevant conversion ratio. In each case, the owner of the original share will be the owner of the new shares. The conversion does not involve the cancellation or redemption of the original shares.

### ***No CGT event happens***

24. If a CGT asset is split into two or more assets and the beneficial owner of the original asset and of each new asset is the same, the split does not result in the happening of a CGT event: subsections 112-25(1) and 112-25(2) of the ITAA 1997. Therefore, no CGT event will happen on the conversion of the GCL shares.

### ***Acquisition date of new shares***

25. Because no CGT event happens, there is also no change in the acquisition date of the shares. That is, the acquisition date of the new shares is the same as the acquisition date of the original share or shares to which they relate. For example, if an original B Class share was acquired before 20 September 1985, the 10 new shares to which that original share relates will also be acquired before that date.

26. The application of the conversion ratio of 33.3 to each A Class share will mean that the conversion will result in fractions of shares from which whole new shares are formed. In these circumstances, where a new share can be formed from fractions that all have the

same acquisition date, the new share will be taken to have been acquired on that date. Otherwise, the fractions from which a new share is formed are taken to be interests in that share, each having the acquisition date of the particular original share from which it was converted: paragraph 1 of TD 2000/31.

***Cost base and reduced cost base of new shares***

27. The cost base and reduced cost base of each new asset is worked out by apportioning in a reasonable way each element of the cost base and reduced cost base of the original asset to each new asset: subsection 112-25(3) of the ITAA 1997.

28. In this case, the Commissioner is satisfied that a reasonable apportionment will be obtained by dividing the cost base and reduced cost base of each original A Class and B Class share by its conversion ratio. The result will be the first element of the cost base and reduced cost base of each new share to which the original share relates.

**CGT: variation of share rights**

29. The rights attaching to the A Class shares will be varied by removing their greater proportionate voting, dividend and capital rights. These variations will not result in the cancellation or redemption of shares under the *Corporations Act 2001*. No change will be made to the rights attaching to the B Class shares, though both the A and B Class shares will be renamed 'ordinary shares' and the maximum shareholding and voting rights percentages will be increased to 49%.

30. As there is no variation of the rights attaching to the B Class shares, and no act, transaction or event in relation to those shares, no CGT event in Division 104 of the ITAA 1997 happens to those shares under the variation of rights part of the arrangement.

31. The CGT events that may be relevant to the variation of the rights attaching to the A Class shares are CGT events A1, C2, D1 and H2.

***CGT events A1 and C2***

32. Taxation Ruling TR 94/30 (paragraphs 8 and 9) provides that the variation of rights attaching to a share does not result in the full disposal of an asset for the purposes of Part IIIA of the *Income Tax Assessment Act 1936* (ITAA 1936) unless there is a cancellation or redemption of the share. Nor does it result in a part disposal of an asset.

33. In the context of the rewritten CGT provisions it is considered that the proposed variation of share rights would not result in CGT event A1 in section 104-10 of the ITAA 1997 (about disposal of an asset) or CGT event C2 in section 104-25 (about cancellation, surrenders or similar endings) happening.

#### ***CGT event D1***

34. Taxation Ruling TR 94/30 (paragraph 10) provides that a variation in rights does not constitute a deemed disposal of shares under subsection 160M(6) of the ITAA 1936. Accordingly the proposed variations in rights will not cause CGT event D1 in section 104-35 of the ITAA 1997 to happen.

#### ***CGT event H2***

35. Paragraph 10 of Taxation Ruling TR 94/30 provides that a variation in rights for money or other consideration may give rise to a deemed disposal under subsection 160M(7) of the ITAA 1936 where the other requirements of the subsection are met. That subsection has been rewritten as CGT event H2.

36. CGT event H2 in section 104-155 of the ITAA 1997 happens if an act, transaction or event occurs in relation to a CGT asset and the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base. The variation in the rights attached to the A Class shares is an act, transaction or event in relation to those shares. Therefore, the variation results in CGT event H2 happening in respect of them.

37. A capital gain is made if the capital proceeds from the event are more than the incidental costs incurred in relation to it. A capital loss is made if the capital proceeds are less than the incidental costs. See subsection 104-155(3) of the ITAA 1997.

38. Subsection 116-20(2) of the ITAA 1997 provides that the capital proceeds from CGT event H2 happening are the money or other consideration received, or entitled to be received, because of the act, transaction or event. Paragraph 29 of Taxation Ruling TR 95/3 provides that 'consideration' for these purposes can include the benefit of mutual promises flowing to parties even if those promises are not in themselves property.

39. The holders of original A Class shares will not receive or be entitled to receive money or other consideration, nor will they receive the benefit of any mutual promises in respect of the event happening. Further, the conversion of original A Class shares into a larger number of shares does not result in the receipt of consideration because it involves a mere change in the nature of property that is already beneficially owned.



40. Therefore, although CGT event H2 will happen in respect of the A Class shares, the holders of those shares will not make a capital gain. They will make a capital loss to the extent of any incidental costs they incur in respect of the variation.

41. The acquisition date of the A Class shares will not be affected by CGT event H2 happening. The operation of section 104-155 of the ITAA 1997 together with Division 109 of the ITAA 1997 does not require or prescribe any alteration to the acquisition date of an asset to which CGT event H2 happens. Therefore, although CGT event H2 will happen in respect of the A Class shares, the shares will retain their existing acquisition date for CGT purposes. For example, if A Class shares were acquired before 20 September 1985, those shares will continue to be treated as acquired before that date even though CGT event H2 has happened in relation to those shares.

#### **Income: conversion and variation**

42. The conversion of shares and the variation of rights will not result in any assessable income being derived by any shareholder under section 6-5 of the ITAA 1997 (about ordinary income) or section 6-10 of the ITAA 1997 (about statutory income).

#### **Issue of shares to round up fractional interests**

43. As a result of the conversion, a small number of A Class shareholders will hold a fraction of a share. The GCL constitution will be amended to allow the GCL Board to issue a shareholder with a part of a share (a fractional share) to round up the fractional share to the nearest whole number.

44. A share issued by a company in relation to other shares that the recipient owns is called a bonus equity: subsection 130-20(1) of the ITAA 1997. Fractional shares issued to the owners of original A Class shares following the conversion in order to round up their total holdings to the nearest whole number, satisfy this definition. The newly issued fraction (the bonus equity) is in relation to the fraction already held (the original equity).

45. The acquisition date of the bonus equity and the cost base and reduced cost base of the original and bonus equities is worked out under Subdivision 130-A of the ITAA 1997. As no amount has been paid for the bonus fractional shares, and no part of them is a dividend, their acquisition date is the same as the acquisition date for the original fractions: items 1 and 3 in the table in subsection 130-20(3).

46. For a bonus fraction issued in relation to an original fraction acquired after 19 September 1985, the first element of the cost base of the original fraction is apportioned in a reasonable way over the original fraction and the bonus fraction: item 1 in the table in subsection 130-20(3). The apportioned cost bases and reduced cost bases are re-merged when, immediately following the issue of the

bonus equity, the original and bonus equities are merged to form a whole share: subsection 112-25(4).

47. This means that the newly rounded share will have the same cost base and reduced cost base as the original fractional share.

### **Value shifting: application of Division 725**

48. Division 725 of the ITAA 1997 may apply where there is a direct value shift under a scheme involving equity interests in an entity. For Division 725 to have any possible consequences, paragraph 725-50(b) requires that a 'controlling entity test' be satisfied.

49. The 'controlling entity test' is satisfied for value shifting purposes if an entity (the controller) controls the target entity at some time starting when the scheme is entered into and ending when the scheme has been carried out: section 725-55 of the ITAA 1997.

50. Subdivision 727-E of the ITAA 1997 sets out the circumstances in which an entity will be regarded as controlling an entity for value shifting purposes. Section 727-355 contains the relevant tests for whether an entity controls a company. On the basis of information provided regarding the share capital structure of GCL, including the current restrictions on the maximum shareholding percentages, there is no entity that would control GCL for value shifting purposes at any time during the arrangement the subject of this Ruling. Accordingly, there are no direct value shifting consequences in respect of that arrangement.

## **Detailed contents list**

51. Below is a detailed contents list for this Class Ruling:

	<b>Paragraph</b>
<b>What this Class Ruling is about</b>	<b>1</b>
Tax law(s)	2
Class of persons	3
Qualifications	4
<b>Date of effect</b>	<b>7</b>
<b>Arrangement</b>	<b>8</b>
Share capital of GCL	9
Conversion of shares and modifications to the GCL Constitution	11
<b>Ruling</b>	<b>16</b>
<b>Explanation</b>	<b>23</b>
CGT: share conversion	23

<i>No CGT event happens</i>	24
<i>Acquisition date of new shares</i>	25
<i>Cost base and reduced cost base of new shares</i>	27
CGT: variation of share rights	29
<i>CGT events A1 and C2</i>	32
<i>CGT event D1</i>	34
<i>CGT event H2</i>	35
Income: conversion and variation	42
Issue of shares to round up fractional interests	43
Value shifting: application of Division 725	48
<b>Detailed contents list</b>	<b>51</b>

**Commissioner of Taxation**

3 November 2004

<i>Previous draft:</i>	- ITAA 1997 104-35
Not previously issued as a draft	- ITAA 1997 104-155
	- ITAA 1997 104-155(3)
<i>Related Rulings/Determinations:</i>	- ITAA 1997 Div 109
CR 2001/1; CR 2001/26; TR 92/1;	- ITAA 1997 112-25
TR 94/30; TR 95/3; TR 97/16;	- ITAA 1997 112-25(1)
TD 2000/31	- ITAA 1997 112-25(2)
	- ITAA 1997 112-25(3)
	- ITAA 1997 112-25(4)
<i>Subject references:</i>	- ITAA 1997 116-20
- CGT event	- ITAA 1997 116-20(2)
- capital gains tax	- ITAA 1997 Subdiv 130-A
- capital proceeds	- ITAA 1997 130-20
- cost base	- ITAA 1997 130-20(1)
- direct value shifting	- ITAA 1997 130-20(3)
- merger	- ITAA 1997 Div 725
- shares	- ITAA 1997 725-50
	- ITAA 1997 725-50(b)
<i>Legislative references:</i>	- ITAA 1997 725-55
- ITAA 1936 Pt IIIA	- ITAA 1997 Subdiv 727-E
- ITAA 1936 160M(6)	- ITAA 1997 727-355
- ITAA 1936 160M(7)	- TAA 1953 Pt IVAAA
- ITAA 1997 6-5	- Copyright Act 1968
- ITAA 1997 6-10	- Corporations Act 2001
- ITAA 1997 Div 104	- Corporations Act 2001 254H
- ITAA 1997 104-10	
- ITAA 1997 104-25	

## ATO references

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