



CR 2004/66 - Income tax: Demerger of Australian Co-Operative Foods Limited

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Class Ruling

Income tax: Demerger of Australian Co-Operative Foods Limited

Contents	Para
What this Class Ruling is about	1
Date of effect	8
Withdrawal	9
Arrangement	10
Ruling	73
Explanation	74
Detailed contents list	79

Preamble

*The number, subject heading, **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 IVA 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 law(s) dealt with in this Ruling are:
- section 45B of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 45BA of the ITAA 1936; and
 - section 45C of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies is the registered members of Dairy Farmers Milk Co-operative Limited on the date of the demerger.

Qualifications

4. The Commissioner makes this Ruling based 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 11 to 72.

6. 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- this Ruling may be withdrawn or modified.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

8. On the basis that the arrangement is implemented by 30 June 2004, this ruling applies to the year of income ended 30 June 2004, or substituted accounting period. However, if the arrangement is not implemented until the year ended 30 June 2005, then this ruling will apply to the year of income ended 30 June 2005 or substituted accounting period. 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 the ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

9. This Ruling is withdrawn and ceases to have effect for income years after 30 June 2005 or substituted accounting periods. The Ruling continues to apply, in respect of the tax laws ruled upon to all persons within the specified class who enter into a specified arrangement during the term of the Ruling. Thus the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to the withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' 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 arrangements are:

- a) Letter from the taxpayer representative dated 7 April 2004 enclosing the Application for Class Ruling;
- b) Letters from the taxpayer representative dated 13 April 2004 and 29 April 2004 providing additional information;
- c) The email dated 23 April 2004 from the taxpayer representative providing additional information;
- d) Draft Explanatory Booklet received with a covering letter dated 3 May 2004;
- e) Letter from the taxpayer representative dated 5 May 2004 providing additional information;
- f) The email from the taxpayer representative dated 10 May 2004 providing additional information; and
- g) The minutes of meetings held on 8 April 2004 and 12 May 2004.

Note: certain information received from the taxpayer's representative has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

11. Australian Co-operative Foods Limited (ACF) and Dairy Farmers Milk Co-operative Limited (DFM) are both co-operatives registered under the *Co-operatives Act 1992 (NSW)*. The group operates in the dairy industry, producing and marketing milk and food products.

12. The proposed restructure of ACF will involve a formal Scheme of Arrangement. Members are asked to vote for or against the Scheme of Arrangement, in a special postal ballot. ACF will need to obtain its members approval to implement Stage 1.

13. Stage 1 and Stage 2 each involves a separate member ballot. The ballot in respect of Stage 2 may occur in the future.

14. As at 4 May 2004, there were 2,850 active members holding 115.8 million shares and 308 inactive members holding 9.8 million shares. These shares were issued at the face value of \$1.00 each. A total of approximately 125.6 million shares will be affected in Stage 1.

15. If 75% of the members who cast formal votes in the Special Postal Ballot approve the Scheme of Arrangement, and the Court approves, orders implementing the Scheme will be made.

Stage 1 – Steps 1 & 2

16. The proposed change of structure will occur in two steps. On the Implementation Date, Step 1 will occur and on completion of that step, Step 2 will follow.
17. The first stage is to interpose a new co-operative, a Supply Co-operative called DFM, which will become part of the Dairy Farmers business and will be referred to in this Ruling as the Supply Co-operative.
18. Section 62 of the *Co-operatives Act 1992 (NSW)* provides that a body corporate is not (merely because it is a body corporate) disqualified from being a member of a co-operative unless the co-operative's rules provide that bodies corporate are disqualified from being members.
19. This ruling request is only in respect of the possible application of section 45B. It has not asked about the capital gains tax (CGT) consequences that may arise from Steps 1 and 2.
20. The first part of the implementation process will be to issue the Supply Co-operative with 5 shares in ACF.
21. In Step 1, all members will have all of their shares in ACF cancelled (except the Supply Co-operative which will continue to hold the 5 shares allotted to it under the Scheme). The face value of the cancelled shares will be applied to subscribe for shares in the Supply Co-operative and the Supply Co-operative, in turn, will be issued with the same aggregate number of shares in ACF as was previously held by the ACF members.
22. All members of ACF (except the Supply Co-operative) will become members of the Supply Co-operative.
23. The implementation of Step 1 will affect certain former members of ACF. The statutory rights of Qualifying Former Members of ACF to be treated as shareholders of ACF in the circumstances described in the *Co-operatives Act* cease to exist and each former member is granted statutory rights to be treated as if he or she were a shareholder of the Supply Co-operative. This occurs by virtue of the *Co-operatives Act*.
24. Immediately upon completion of Step 1, and on the same day, Step 2 takes place. The ballot which authorises Step 1 also authorises Step 2.
25. The Supply Co-operative will divest at least 80% of its interest in Restructured ACF to its members as part of a demerger. This process will involve 80% of the Supply Co-operative's shares in Restructured ACF being cancelled. The Supply Co-operative will direct the capital paid in respect of those shares (payable to the Supply Co-operative) to the members of the Supply Co-operative to fund the cancellation of 80% of the members' new shares in the Supply Co-operative. Members in turn will direct payment of the face

value of the cancelled shares back to Restructured ACF to be applied as subscription moneys for new shares in Restructured ACF.

26. The remaining 20% of shares in Restructured ACF held by the Supply Co-operative will continue to be held by it.

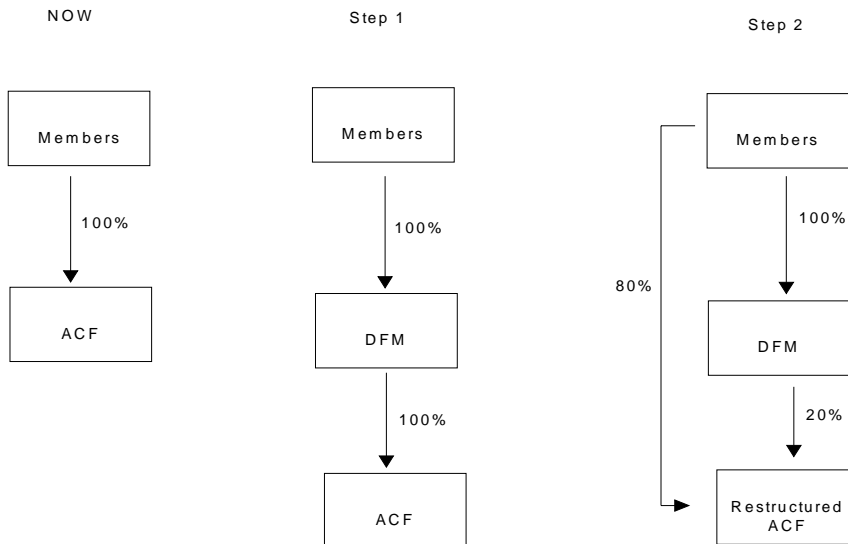
27. Step 2 does not make any further changes to the statutory rights of Qualifying Former Members as established by Step 1.

28. The completion of Step 2 means that the Scheme of Arrangement has been finalised with the following outcomes:

1. Members will now have separate holdings in two Co-operatives:
 - The shares held in Restructured ACF will have been reduced to 80% of the number originally held by Members in ACF.
 - The reduction in Restructured ACF shares will be balanced by a new holding by the Supply Co-operative equal to 20% in number of Member's original shareholding in ACF.
 - Both Restructured ACF and the Supply Co-operative will be co-operatives.
2. The Supply Co-operative will be 100% owned by the persons who were members of ACF at the Implementation Date.
3. The Supply Co-operative will have an investment in Restructured ACF which will initially be approximately 20% of the issued capital.
4. Upon completion, the proportionality of ownership interests held by the members in Restructured ACF, whether directly or indirectly through the Supply Co-operative, will remain unchanged.

29. No assets will pass from Restructured ACF to the Supply Co-operative under the demerger or under any contractual arrangement after the demerger. Restructured ACF will continue to be the owner of all its assets that it currently holds.

30. The following is a diagrammatic representation of Steps 1 and 2 of Stage 1:



Reasons for the Restructure

31. The proposal has unanimous support from the directors of ACF. The commercial reasons put forward by the directors for recommending Stage 1, irrespective of whether Stage 2 (which involves Restructured ACF being converted to a company) is embarked upon or not, include:

- a Milk Supply Agreement which is a transparent contractual arrangement to determine the commercial price of milk;
- a new Supply Co-operative (DFM) which will focus on the needs of the farmer members and their issues, including the security of milk off-take and providing farmer members with the option to grow their milk volumes;
- the Board of Restructured ACF is thus allowed to concentrate on the needs of the business of processing milk and manufacturing and marketing milk products and a wide range of dairy products;
- a smaller Restructured ACF Board which will no longer have responsibility for farmer issues and can focus on improving the performance of the business of Restructured ACF;

- a favourable reaction from Restructured ACF's financiers. The Board believes that Stage 1 is likely to result in its financiers agreeing to more liberal covenant restraints and lower interest rate margins for Restructured ACF; and
- Restructured ACF is provided with a means to access external, non farmer capital by moving to Stage 2.

Voting Rights

32. In terms of voting rights, after Stage 1, legal control of Restructured ACF will continue to rest with active farmer members who will control a majority of votes at general meetings or postal ballots on a 'one member- one vote' basis. Although the Supply Co-operative initially will hold approximately 20% of the issued shares of Restructured ACF, after the implementation date, it will have only one vote at a general meeting or in a postal ballot.

Qualifying Former Members

33. Qualifying former members are those former members of ACF who have had their membership cancelled under Section 127 of the Co-operatives Act and their shares forfeited under Section 128 of the Co-operatives Act within 5 years prior to the Implementation Date.

34. Section 139 of the Co-operatives Act requires ACF to treat Qualifying Former Members as if they were still shareholders if certain triggering events occur within 5 years after their shares are forfeited. One of these triggering events is the conversion of the co-operative to a company.

35. A consequence of the Scheme of Arrangement is that Qualifying Former Members by statute have all their Section 139 rights transferred to the Supply Co-operative and lose all such rights against Restructured ACF.

36. The Board of ACF believes that Qualifying Former Members of ACF should be given the opportunity, after implementation of the Scheme of Arrangement, for the balance of the statutory five year period, to take up shares in any company into which Restructured ACF is converted to the same extent as Members of ACF at the Implementation date, that is up to 80% of their forfeited shares.

37. The mechanism which has been devised to give effect to this objective is the offer of limited term Convertible CCUs to all Qualifying Former Members of ACF provided that they pay for the number of Convertible CCUs they subscribe for at \$1.00 per Convertible Co-operative Capital Units (CCU). This opportunity will also be afforded to the legal personal representative of such Qualifying Former Members.

38. Qualifying Former Members who take up the offer of Convertible CCUs to the extent to which they take up Convertible CCUs will lose the rights they would otherwise have had under the *Co-operatives Act* to be treated as if they were shareholders in the Supply Co-operative and thereby to participate in future benefits that might flow to persons holding shares in the Supply Co-operative. Qualifying Former Members will retain their statutory rights in the Supply Co-operative in respect of 20% of their forfeited shares plus the extent to which they do not take up the offer of Convertible CCUs in Restructured ACF.

Stage 2 – Conversion to a Company

39. Stage 2 is not part of the proposed restructure the subject of the member's special postal ballot. However, the intention of the current Board of ACF is to proceed to Stage 2 at a later date when in the opinion of the Board, the conditions are suitable. Stage 2 cannot take place without a second ballot of the membership of Restructured ACF.

40. Stage 2 will not involve a Scheme of Arrangement or court approval but it will involve the distribution to members of comprehensive disclosure documentation.

41. Stage 2 involves a special postal ballot of the membership to convert the co-operative Australian Co-operative Foods Limited into a company which, for the sake of convenience, is called Dairy Farmers Limited (DFL).

42. 75% of the members who cast formal votes in the postal ballot must vote in favour of the conversion to enable the conversion to occur.

43. At the time the resolution to convert Restructured ACF to a company is made, there may be two categories of former members of ACF:

1. ACF members who become former members after the Implementation Date will become shareholders in the new company on the payment of \$1.00 per share by operation of the *Co-operatives Act* if the resolution to convert to a company occurs within the statutory 5 year period after the members' shares were forfeited.
2. Qualifying Former Members who hold Convertible CCUs which become shares if the resolution to convert to a company occurs during the term of the CCU.

44. Once member approval is obtained for this conversion, and the new company comes into existence, the Board of the company will then have the option of raising share capital from non farmers. It could do this in a variety of ways with listing on the Australian Stock Exchange being one option for the Board.

45. If Restructured ACF converts to a company (DFL), the intention is for DFL to retain co-operative status for income tax purposes, at least up until listing.

Distributions to Members

46. Distributions to members from retained earnings of ACF have occurred in the following forms in the past:

- Cash dividends paid per ACF share;
- Dividends on ACF shares satisfied by the issue of additional ACF shares or reinvested by way of loans convertible into MCUs (Members Capital Units) in ACF;
- Distributions paid in cash based on business done with ACF; and
- Distributions based on business done satisfied by the issue of additional ACF shares or reinvestment by way of loans convertible to MCUs in ACF.

47. Distributions have been made from current period profits as well as distributions from retained earnings by way of special bonus ACF share issues.

48. The directors of the Supply Co-operative intend to continue the policies of ACF in relation to distributions based on business done and shareholdings in the Supply Co-operative, at least until ACF is converted to a public company.

49. In determining the proportion of distributions of the Supply Co-operative to be paid based on business done, the directors intend to take into account the dividends on ACF shares that members receive on their direct shareholding in ACF after the implementation date.

Changes to ACF Rules

50. There have been a number of changes to the rules of ACF. In particular, active membership provisions have been amended with the transitional rule, direct milk supply rule and indirect milk supply rule.

51. The effect of these amendments is to ensure that an active member of the Supply Co-operative will satisfy the rules for active membership of Restructured ACF.

Milk Supply Agreement

52. If Stage 1 is approved by Members, a 10 year Milk Supply Agreement is proposed, which obliges Restructured ACF to buy from the Supply Co-operative all milk produced by farmer members of the Supply Co-operative at dairy farms at which ACF currently collects milk. Restructured ACF must collect this milk.

53. The Supply Co-operative and Restructured ACF will enter into the Milk Supply agreement so that the Supply Co-operative can secure a long term dependable outlet at commercial prices for milk produced by its farmer members which accommodates on farm growth. Likewise, by entering into the Milk Supply agreement, Restructured ACF can secure a consistent long term supply of milk of suitable quality, at commercial prices.

54. The responsibilities of Restructured ACF and the Supply Co-operative in relation to the collection and transportation are clearly set out in the Milk Supply Agreement. Restructured ACF is responsible for collection and transportation of milk from the Supply Co-operative's direct farmer members.

55. The Milk Supply Agreement will prohibit Restructured ACF buying milk from individual farmers for so long as the Supply Co-operative and Restructured ACF are related parties.

56. Regarding payments, at the direction of the Supply Co-operative, Restructured ACF will pay the Supply Co-operatives' members directly on the 14th day of each month for milk supplied to the Supply Co-operative and on-supplied to Restructured ACF during the month immediately preceding.

57. Property in the milk being purchased by Restructured ACF from the Supply Co-operative shall pass to Restructured ACF at the same time as property in the milk which is being purchased by the Supply Co-operative passes to the Supply Co-operative.

58. Risk of loss or damage to the milk being purchased by Restructured ACF from the Supply Co-operative shall pass to Restructured ACF as soon as it is collected by Restructured ACF.

59. Restructured ACF will provide to the Supply Co-operative the administrative services. So long as Restructured ACF provides the Administrative Services, the Supply Co-operative shall pay to Restructured ACF the administrative services fee by quarterly instalments.

60. A reasonable amount of the Administration Services Fee (currently it is \$100,000) is to be paid by the Supply-Co-operative for provision of the agreed administrative services.

61. The Administrative Services and the Administration Services fee will be regularly reviewed by Restructured ACF and the Supply Co-operative.

62. The Supply Co-operative will receive an aggregation fee from Restructured ACF in order to cover or reimburse the Supply Co-operative for the costs and expenses connected with the consolidation or aggregation of the milk supply for on sale to Restructured ACF.

63. Restructured ACF and the Supply Co-operative agree that the amount of \$1,100,000 per annum is currently a reasonable amount for the Aggregation fee. This fee will be reviewed annually. The amount may increase after the first year if the actual costs exceed \$1.1 million but only to the extent of increases in the Consumer Price Index. The amount can only be reduced if there is a 10% reduction in milk volumes.

64. If Restructured ACF becomes a public company, Restructured ACF is not required to pay the aggregation fee unless and until Restructured ACF obtains member approval under Chapter 2E of the *Corporations Act 2001*.

Share Acquisition Program of DFM

65. The Share Acquisition Program for the Supply Co-operative (that is, DFM) will take effect on the Implementation Date in respect of milk payments to be made after that date.

66. The Share Acquisition Program will terminate on the date when the last required amount of money is contributed. It has been designed to enable it to be continued for at least five years.

67. The total number of shares to be issued is 100 million shares at \$1.00 each.

68. The purpose of the proposed Share Acquisition Program is to require each participating member to increase the member's investment in the Supply Co-operative to a level proportionate to the amount of milk supplied by the member. By progressively aligning members' shareholding with milk volume, the Supply Co-operative will be able to distribute profits as dividends on shares and still recognise the supply by members of milk.

69. Under the Share Acquisition Program, participating members are required to take up additional shares in the Supply Co-operative. These additional shares are to be paid for by deductions from milk cheques, being approximately 1 cent per litre of milk.

70. Once a member has reached the member's maximum share entitlement, deductions from milk cheques will cease.

Loan Agreement

71. The Supply Co-operative (the lender) and Restructured ACF (the borrower) will enter into a loan agreement where the lender will advance funds raised under the Share Acquisition Program which it does not require for its own business purposes to the borrower.

72. The loan agreement sets out the terms of the loan, including the interest rate, termination date, event of default and payments.

Ruling

73. The Commissioner will not make a determination under paragraph 45B(3)(a) of the ITAA 1936 that section 45BA applies to the whole, or any part, of the demerger benefit provided to the shareholders under the demerger. Nor will the Commissioner make a determination under paragraph 45B(3)(b) that section 45C applies to the whole, or any part, of the capital benefit provided to the shareholders under the demerger.

Explanation

Section 45B – Schemes to provide certain benefits

74. Section 45B applies to ensure that relevant amounts are treated as dividends for taxation purposes if:

- a) components of a demerger allocation as between capital and profit do not reflect the circumstances of a demerger; or
- b) certain payments, allocations and distributions are made in substitution for dividends.

75. Specifically, the provision applies where:

- a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a));
- b) under the scheme a taxpayer, who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
- c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

76. The provision of ownership interests in a company, a distribution, or the doing of a thing in relation to an ownership interest that has the effect of increasing the value of an ownership interest owned by the person which occurs under a demerger may be considered to be a demerger benefit and a capital benefit for the purposes of section 45B (subsections 45B(4) and (5)). However, if the provision of interests, the distribution or the thing done involves the

person receiving a demerger dividend then, to that extent, it cannot be treated as a capital benefit (subsection 45B(6)). Accordingly, to the extent that the demerger benefit does not involve the receipt of a demerger dividend, it will constitute both a demerger benefit and a capital benefit.

77. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) are met, the requisite purpose of enabling the registered members of DFM to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present. In other words, having regard to the relevant circumstances of the demerger scheme, referred to in subsection 45B(8), it would not be concluded that any of the parties to the scheme entered into it or carried it out to enable the members to obtain a tax benefit.

78. It is apparent that the ownership interests provided to the registered members of DFM, being the shares in Restructured ACF, are not provided for the requisite purpose in section 45B. Rather, after having regard to the circumstances in subsection 45B(8), in particular paragraph 45B(8)(k) which refers to matters in subparagraphs 177D(b)(i) to (viii), it is apparent that the ownership interests in Restructured ACF are provided in the course of a scheme to enhance business efficiency in regard to both DFM and Restructured ACF. The provision of the ownership interests as demerger benefits or capital benefits is a natural incident of the demerger scheme and not a substantial purpose of it.

Detailed contents list

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

	Paragraph
What this Class Ruling is about	1
Tax law(s)	2
Class of persons	3
Qualifications	4
Date of effect	8
Withdrawal	9
Arrangement	10
Reasons for the Restructure	31
Voting Rights	32
Qualifying Former Members	33
Stage 2 – Conversion to a Company	39
Distributions to Members	46
Changes to ACF Rules	50

Milk Supply Agreement	52
Share Acquisition Program of DFM	65
Loan Agreement	71
Ruling	73
Explanation	74
Section 45B – Schemes to provide certain benefits	74
Detailed contents list	79

Commissioner of Taxation

23 June 2004

<i>Previous draft:</i>	- ITAA 1936 45B(3)(b)
Not previously issued as a draft	- ITAA 1936 45B(4)
	- ITAA 1936 45B(5)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(6)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 45B(8)
TR 97/16	- ITAA 1936 45B(8)(k)
	- ITAA 1936 45BA
<i>Subject references:</i>	- ITAA 1936 45C
- capital benefit	- ITAA 1936 177D(b)(i)
- demerger	- ITAA 1936 177D(b)(ii)
- demerger allocation	- ITAA 1936 177D(b)(iii)
- demerger benefit	- ITAA 1936 177D(b)(iv)
- schemes to provide certain	- ITAA 1936 177D(b)(v)
benefits	- ITAA 1936 177D(b)(vi)
	- ITAA 1936 177D(b)(vii)
	- ITAA 1936 177D(b)(viii)
<i>Legislative references:</i>	- Co-operatives Act 1992 (NSW)
- ITAA 1936 45B	- Copyright Act 1968
- ITAA 1936 45B(2)(a)	- Corporations Act 2001
- ITAA 1936 45B(2)(b)	- TAA 1953 Pt IVA
- ITAA 1936 45B(2)(c)	
- ITAA 1936 45B(3)(a)	

ATO references

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