

CR 2005/65 - Income tax: scrip for scrip roll-over: merger of CI Resources Limited and Phosphate Resources Limited

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Class Ruling

Income tax: scrip for scrip roll-over: merger of CI Resources Limited and Phosphate Resources Limited

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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

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 the following provisions of the *Income Tax Assessment Act 1997* (ITAA 1997):

- section 104-10;
- section 116-20; and
- Subdivision 124-M.

Class of persons

3. The class of persons to which this Ruling applies are the shareholders in Phosphate Resources Limited (PRL) who:

- (a) hold their PRL shares on capital account;
- (b) participate in the scheme of arrangement under which CI Resources Limited (CII) acquires those shares;
- (c) are 'residents of Australia' within the meaning of that expression in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- (d) are not 'significant stakeholders' within the meaning of that expression in Subdivision 124-M of the ITAA 1997.

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 9 to 14.
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 - this Ruling may be withdrawn or modified.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. This Class Ruling applies to the income year ended 30 June 2006.

Arrangement

9. The arrangement that is the subject of this Ruling is described below. The description is based on, and includes, the following documents:
 - (a) Class Ruling application dated 3 March 2005 from Prospera Partners requesting the Australian Taxation Office (ATO) to make a Class Ruling in relation to the capital gains scrip for scrip roll-over provisions as they apply to the acquisition of PRL shares by CII;
 - (b) the documentation accompanying the application:
 - Implementation Agreement between PRL and CII dated 18 February 2005; and

- Scheme of Arrangement between PRL and the holders of fully paid ordinary shares in PRL; and

(c) correspondence from Prospera Partners dated 29 March 2005, 8 April 2005, 19 April 2005, 28 April 2005 and 11 May 2005 providing further clarification and information to the Tax Office.

10. On 21 February 2005, CII announced to the Australian Stock Exchange (ASX) a proposed merger with PRL pursuant to a scheme of arrangement. CII (which has more than 300 members) currently owns 39.06% of the shares in PRL.

11. Clause 3.2 of the Scheme of Arrangement provides that, subject to the satisfaction of certain conditions precedent, the remaining PRL shares will be transferred to CII with effect from the merger implementation date (as defined in clause 1.1 of the Implementation Agreement) without the need for any further act by any PRL shareholder.

12. Clause 3.3 of the Scheme of Arrangement provides that in consideration of the transfer of PRL shares to CII, CII will pay the scheme consideration to PRL shareholders. The scheme consideration is \$1.00 and 11 CII shares for each PRL share.

13. The shares to which certain foreign PRL shareholders would otherwise be entitled will be issued to a nominee appointed by PRL for sale. The nominee will remit the net sale proceeds to the foreign shareholders.

14. Both CII and PRL are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936.

Ruling

15. CGT event A1 in section 104-10 of the ITAA 1997 will happen as a result of a PRL shareholder disposing of a PRL share to CII under the arrangement described in this Ruling.

16. The event will happen on the merger implementation date when the PRL shareholder ceases to own the share: subsection 104-10(3) of the ITAA 1997.

17. A shareholder will make a capital gain from CGT event A1 happening if the capital proceeds for a PRL share exceeds its cost base. The shareholder will make a capital loss if those capital proceeds are less than the share's reduced cost base: subsection 104-10(4) of the ITAA 1997.

18. The capital proceeds for each share are \$1.00 plus the market value of 11 CII shares at the time when CGT event A1 happens to the PRL share: section 116-20 of the ITAA 1997.

19. A shareholder who makes a capital gain from the disposal of a PRL share can choose roll-over under Subdivision 124-M of the ITAA 1997 if any capital gain that could be made upon a future CGT event happening in relation to a replacement share in CII would not be disregarded (except because of a roll-over).

20. If a shareholder chooses roll-over, a capital gain from a PRL share is disregarded to the extent that the shareholder received CII shares as consideration for its disposal. The capital gain is not disregarded to the extent that the shareholder received cash for the disposal of their PRL share: section 124-790 of the ITAA 1997.

21. If a shareholder chooses roll-over, the cost base of a replacement CII share is determined by reasonably attributing to it the cost base of the PRL share for which it was exchanged and for which a partial roll-over was obtained. However, the cost base of the PRL share must first be reduced by so much of it that is taken into account in determining the shareholder's capital gain relating to the cash proceeds: subsections 124-785(2) and (3) of the ITAA 1997.

Explanation

CGT event A1 and capital proceeds

22. CGT event A1 in section 104-10 of the ITAA 1997 happens if there is a change in the ownership of an asset from one entity to another. The event happens when a contract to dispose of the asset is entered into or, if there is no contract, when the change of ownership occurs.

23. The time when CGT event A1 happens determines the income year in which any capital gain or loss is made.

24. The Addendum to Taxation Determination TD 2002/4 indicates that a takeover or merger effected by a court ordered scheme of arrangement does not involve a disposal of shares under a contract.

25. CGT event A1 will therefore happen to all PRL shareholders when the shares are transferred to CII on the merger implementation date.

26. The time of CGT event A1 happening is also relevant to determining the capital proceeds received for each PRL share. Section 116-20 of the ITAA 1997 provides that capital proceeds from a CGT event are the money and the market value of any property received (worked out at the time of the event happening).

27. PRL shareholders must therefore determine the market value of a CII share at the time they dispose of their PRL shares. To facilitate practical compliance, the Commissioner will accept the lower of the following amounts as representing the market value of a CII share at that time:

- the volume weighted average price (VWAP) of the shares on the merger implementation date (provided that the CII shares are quoted, traded and priced on a post-merger basis – that is, on the basis of 81,147,699 fully paid ordinary shares); and

- \$A0.19 being the midpoint in the range of CII fully paid ordinary share prices specified in the independent valuation that was provided for the purposes of the Scheme of Arrangement.*

Availability of scrip for scrip roll-over

28. Scrip for scrip roll-over enables a shareholder to disregard a capital gain from a share that is disposed of as part of a corporate takeover or merger if the shareholder receives in exchange a replacement share.

29. The capital gain is disregarded completely if the only capital proceeds the shareholder receives is a replacement share. If the shareholder receives some other form of capital proceeds, the capital gain is disregarded in part. The roll-over also provides that the cost base and reduced cost base of the replacement shares is based on the cost base and reduced cost base of the original shares at the time of the roll-over.

30. Subdivision 124-M of the ITAA 1997 contains a number of conditions for, and exceptions to, the eligibility of a shareholder to choose scrip for scrip roll-over. Below is an outline of the main conditions and exceptions which are relevant to the circumstances of the arrangement that is the subject of this Ruling.

Subparagraph 124-780(1)(a)(i) of the ITAA 1997 requires an entity (PRL shareholder) to exchange a share in a company for a share in another company

31. This requirement will be satisfied because part of the consideration PRL shareholders will receive for each PRL share exchanged are CII shares (although only a partial roll-over will be available).

Paragraphs 124-780(1)(b) and 124-780(2)(a) of the ITAA 1997 require that shares in an entity (PRL – the original entity) be exchanged in consequence of a single arrangement that results in another entity (CII – the acquiring entity) becoming the owner of 80% or more of the voting shares in the original entity

32. In the context of the scrip for scrip provisions the merger of CII and PRL under the scheme of arrangement is considered to be a single arrangement.

33. The only issued shares in PRL are ordinary shares. These shares satisfy the definition of voting shares in subsection 995-1(1) of the ITAA 1997.

* PRL shareholders should not take the Commissioner's acceptance of the midpoint of the independent valuation as a verification of that independent valuation.

34. Upon implementation of the scheme of arrangement this requirement will be satisfied as CII will become the owner of all PRL ordinary shares.

Paragraphs 124-780(1)(b) and 124-780(2)(b) of the ITAA 1997 require that the exchange of shares be in consequence of a single arrangement in which at least all owners of voting shares in the original entity (PRL) (other than an entity referred to in paragraph 124-780(2)(a)) could participate

35. This requirement is satisfied as all PRL shareholders (other than CII) will be able to participate in the scheme of arrangement.

Paragraphs 124-780(1)(b) and 124-780(2)(c) of the ITAA 1997 require that participation in the arrangement be on substantially the same terms for all the owners of interests of a particular type in the original entity

36. This requirement will be satisfied as the scheme provides for the same consideration to be paid to all PRL shareholders.

37. The issuing to a nominee for sale the CII shares to which foreign shareholders of PRL would otherwise be entitled will not prevent the arrangement being on substantially the same terms for all owners of shares in PRL.

Paragraphs 124-780(1)(c) and 124-780(3)(a) of the ITAA 1997 require the original interest holder (a PRL shareholder) to have acquired its original interest (a PRL share) on or after 20 September 1985

38. This requirement will be satisfied as all of the shares in PRL were acquired on or after 20 September 1985.

Paragraphs 124-780(1)(c) and 124-780(3)(b) of the ITAA 1997 require that, apart from the roll-over, the original interest holder (a PRL shareholder) would make a capital gain from a CGT event happening in relation to the original interest (a PRL share)

39. Whether a PRL shareholder would, apart from the roll-over, make a capital gain from the disposal of any of its shares to CII is a question of fact that is dependent on the specific circumstances of each shareholder – in particular, the cost base of each PRL share and the value of the capital proceeds received. Paragraph 19 limits this Ruling in this regard.

Paragraphs 124-780(1)(c) and 124-780(3)(c) of the ITAA 1997 require that the replacement interest is in the acquiring entity (CII) or the ultimate holding company of the wholly-owned group of which it is a member (CII)

40. This requirement will be satisfied as the replacement shares received by PRL shareholders will be in CII which is the acquiring entity. CII is not and will not be a member of a wholly-owned group just before the start of the scheme of arrangement.

Paragraphs 124-780(1)(c) and 124-780(3)(d) of the ITAA 1997 require that the original interest holder (a PRL shareholder) choose to obtain the roll-over

41. Whether roll-over is chosen is a question of fact. Paragraph 20 limits this Ruling to shares in respect of which roll-over is chosen.

Additional requirements in subsection 124-780(5) of the ITAA 1997 must be satisfied if the original interest holder (a PRL shareholder) and an acquiring entity (CII) did not deal with each other at arm's length and:

- (a) neither the original entity (PRL) nor the replacement entity (CII) had at least 300 members just before the arrangement started: paragraph 124-780(4)(a) of the ITAA 1997; or***
- (b) the original interest holder (a PRL shareholder), the original entity (PRL) and the acquiring entity (CII) were all members of the same linked group just before the arrangement started: paragraph 124-780(4)(b) of the ITAA 1997***

42. Paragraph 124-780(4)(a) will not apply because CII will have more than 300 members before the arrangement starts.

43. Section 124-810 of the ITAA 1997 will not apply to CII as its ownership is not concentrated in the manner contemplated by that section.

44. Further, paragraph 124-780(4)(b) of the ITAA 1997 will not apply because PRL and CII will not be members of the same linked group (within the meaning in section 170-260 of the ITAA 1997) just before the arrangement starts.

Exceptions to obtaining scrip for scrip roll-over

Paragraph 124-795(2)(a) of the ITAA 1997 provides that the roll-over is not available if any capital gain the original interest holder (a PRL shareholder) might make from their replacement interest (a CII share) would be disregarded

45. This exception may apply, if for example, the shareholder holds their CII shares as trading stock. Paragraph 19 limits this Ruling in this regard.

Paragraph 124-795(2)(b) of the ITAA 1997 provides that the roll-over is not available if the original interest holder (a PRL shareholder) and the acquiring entity (CII) are members of the same wholly-owned group just before the original interest holder stops owning their original interest (a PRL share), and the acquiring entity (CII) is a foreign resident

46. CII is an Australian resident. Therefore this exception will not apply.

Partial roll-over

47. Subsection 124-790(1) of the ITAA 1997 provides that an original interest holder (a PRL shareholder) will obtain only a partial roll-over if its capital proceeds include something other than a replacement interest (a CII share).

48. Under the arrangement PRL shareholders will receive \$1.00 cash and 11 CII shares for each PRL share disposed of. Roll-over will not be available to the extent of the cash (ineligible proceeds) received.

49. In calculating the capital gain attributable to their ineligible proceeds, a PRL shareholder should deduct from those proceeds a reasonable portion of the cost base of their PRL share (just before its disposal to CII): subsection 124-790(2) of the ITAA 1997.

50. In making a reasonable apportionment of the cost base of a PRL share, it would be appropriate for a shareholder to make an apportionment having regard to the value of the ineligible proceeds and the CII shares on the merger implementation date.

Cost base and reduced cost base of ABK share

51. The first element of the cost base and reduced cost base of a CII share is worked out having regard to that portion of the cost base of a PRL share that was not taken into account in working out the capital gain in respect of the ineligible proceeds: subsections 124-785(2), (3) and (4) of the ITAA 1997.

Example

52. The following example provides guidance for PRL shareholders to work out the capital gains consequences if they choose roll-over in respect of the disposal of their shares to CII.

53. The example shows how to work out:

- a capital gain attributable to the ineligible proceeds they received; and
- the first element of the cost base and reduced cost base of their replacement CII shares.

54. Where a PRL shareholder works out the first element of the cost base and reduced cost base of their CII shares in accordance with the approach adopted in the example, the Tax Office will accept that this represents a reasonable attribution of the cost base of each PRL share. However, it is recognised that this approach may not give the only reasonable attribution.

55. *Matthew acquired 1,000 shares in PRL for \$2,000 in September 2002. Assume that the shares are transferred to CII under the scheme of arrangement on 1 August 2005. Matthew received \$1,000 cash (\$1.00 x 1,000) and 11,000 CII shares. Assume that under the guidelines set out in paragraph 27 of this Ruling, the market value of a CII share on 1 August 2005 is \$0.19.*

Capital gain attributable to ineligible proceeds

56. *Matthew chooses for roll-over to apply to the extent he is able. Matthew works out the capital gain from the ineligible proceeds using the formula:*

$$\begin{aligned} \text{Ineligible proceeds} &= \$1,000 \\ \text{Total proceeds} &= \$1,000 + 11,000 \times \$0.19 \\ &= \$3,090 \end{aligned}$$

Capital gain = Ineligible capital proceeds – cost base of ineligible part

Cost base of ineligible part = Cost base of PRL shares × Ineligible proceeds/Total proceeds

$$\begin{aligned} &= \$2,000 \times \$1,000/\$3,090 \\ &= \$647.25 \end{aligned}$$

$$\begin{aligned} \text{Capital gain} &= \$1,000 - \$647.25 \\ &= \$352.75 \end{aligned}$$

Cost base of CII shares

57. *The first element of the cost base of Matthew's 11,000 CII shares is determined by reference to the cost base of his PRL shares that was not taken into account in working out the capital gain Matthew made in respect of the ineligible proceeds. The cost base of Matthew's shares will therefore be:*

Cost base of PRL shares = \$2,000

*Cost base attributable to ineligible proceeds = \$647.25
(taken into account above)*

*First element of cost base of each CII share = \$0.12
(ie \$2,000 - \$647.25)/11,000)*

58. *The first element of the reduced cost base of Matthew's shares will be calculated in a similar manner.*

Detailed contents list

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Commissioner of Taxation

13 July 2005

<i>Previous draft:</i>	- ITAA 1997 104-10(4)
Not previously issued as a draft	- ITAA 1997 116-20
	- ITAA 1997 Subdiv 124-M
<i>Related Rulings/Determinations:</i>	- ITAA 1997 124-780(1)(a)(i)
CR 2001/1; TR 92/1; TR 97/16;	- ITAA 1997 124-780(1)(b)
TD 2002/4	- ITAA 1997 124-780(1)(c)
	- ITAA 1997 124-780(2)(a)
<i>Subject references:</i>	- ITAA 1997 124-780(2)(b)
- arrangement	- ITAA 1997 124-780(2)(c)
- capital proceeds	- ITAA 1997 124-780(3)(a)
- company	- ITAA 1997 124-780(3)(b)
- cost base	- ITAA 1997 124-780(3)(c)
- interests	- ITAA 1997 124-780(3)(d)
- merger	- ITAA 1997 124-780(4)(a)
- ordinary share	- ITAA 1997 124-780(4)(b)
- original interest	- ITAA 1997 124-780(5)
- replacement interest	- ITAA 1997 124-785(2)
- resident	- ITAA 1997 124-785(3)
- roll-over	- ITAA 1997 124-785(4)
- roll-over relief	- ITAA 1997 124-790
- scrip	- ITAA 1997 124-790(1)
- scrip for scrip	- ITAA 1997 124-790(2)
- share	- ITAA 1997 124-795(2)(a)
- shareholder	- ITAA 1997 124-795(2)(b)
	- ITAA 1997 124-810
	- ITAA 1997 170-260
<i>Legislative references:</i>	- ITAA 1997 995-1(1)
- ITAA 1936 6(1)	- TAA 1953 Pt IVAAA
- ITAA 1997 104-10	- Copyright Act 1968
- ITAA 1997 104-10(3)	

ATO references

NO: 2005/9520
 ISSN: 1445-2014
 ATOLaw topic: Income Tax ~ Capital Gains Tax ~ roll-overs - scrip for scrip