


CR 2007/10 - Income tax: capital gains: scrip for scrip roll-over: exchange of units in NMFN Split Equity Fund No. 1 for units in Wholesale Australian Equity Value Fund

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Class Ruling

Income tax: capital gains: scrip for scrip roll-over: exchange of units in NMFM Split Equity Fund No. 1 for units in Wholesale Australian Equity Value Fund

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📌 This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provision dealt with in this Ruling is Subdivision 124-M of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies is the holders of units in NMFM Split Equity Fund No. 1 (SEF) who:

- (a) are 'residents of Australia' as that term is defined in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- (b) acquired their interest in SEF on or after 20 September 1985;

- (c) will dispose of their units in SEF to National Mutual Funds Management Limited (NMFM) as the responsible entity for the SEF in exchange for units in Wholesale Australian Equity Value Fund (WAEV); and
- (d) are not 'significant stakeholders' or 'common stakeholders' within the meaning of those expressions as used in Subdivision 124-M of the ITAA 1997.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in the Ruling.
5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 17 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
 - this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies to the income year ending 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.
9. 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. Furthermore, the Ruling only applies to the extent that:
 - it is not later withdrawn by notice in the *Gazette*; or
 - the relevant provisions are not amended.

10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The scheme that is the subject of the Ruling is described below. The description is based on the following documents:

- Class Ruling application dated 1 November 2006 from NMFM requesting the Commissioner of Taxation to make a Class Ruling in relation to the scrip for scrip roll-over provisions as they apply to the exchange of units in SEF for units in WAEV;
- NMFM SEF No. 1 Second Supplement Deed Poll 8 July 2002;
- Wholesale Australian Equity Value Fund Deed 12 August 2005;
- List of SEF unit holders at 30 June 2006;
- List of WAEV unit holders at 30 June 2006;
- Implementation Deed dated 16 October 2006;
- List of SEF and WAEV unit holders after merger; and
- Correspondence from NMFM dated 1 December 2006, 7 December 2006 and 21 December 2006.

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

14. NMFM as trustee of and the responsible entity for SEF and WAEV is an Australian resident trust estate as defined in subsection 95(2) of the ITAA 1936 and a resident trust for CGT purposes as defined in section 995-1 of the ITAA 1997.

15. The Scheme that is the subject of this Ruling involves the merger of SEF and WAEV through the acquisition of the capital units in SEF by NMFM as responsible entity for WAEV.

16. On 14 November 2006, NMFM as the responsible entity of SEF announced an offer to acquire the capital units in SEF. The offer was made to all SEF unit holders and received acceptances from 92% of SEF unit holders. Under the offer, SEF unit holders will receive approximately 1.6 WAEV class A units for every SEF capital unit they hold on the 'merger record date' (expected to be 9 February 2007). SEF unit holders will not receive any other consideration under the offer.

17. Under the merger NMFM, as the responsible entity for SEF also undertook, on 21 November 2006, a compulsory redemption of all SEF income units for 0.001 cent per unit.

Ruling

18. Subject to the qualifications in paragraphs 4 to 6 of this Ruling, holders of units in SEF who are within the class of persons to whom this Ruling applies can choose roll-over under Subdivision 124-M of the ITAA 1997 for the disposal of a SEF unit acquired after 19 September 1985 if:

- (a) apart from the roll-over, they would make a capital gain from the disposal of the SEF units under the Scheme; and
- (b) they might make a capital gain from a replacement unit in WAEV which would not be disregarded (except because of a roll-over).

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

CGT event A1 happens

19. CGT event A1 will happen when SEF unit holders dispose of their SEF units for WAEV units on the Implementation Date (expected to be 10 February 2007) under the Scheme (section 104-10 of the ITAA 1997).

20. SEF unit holders will make a capital gain from CGT event A1 happening if the capital proceeds received for the disposal of each SEF unit exceeds its cost base. SEF unit holders 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).

21. The capital proceeds received for each SEF unit will be the market value of each WAEV unit received under the Scheme (subsection 116-20(1) of the ITAA 1997).

Choosing scrip for scrip roll-over

22. Scrip for scrip roll-over enables a unit holder to disregard a capital gain they make from a unit that is transferred as part of a takeover or merger to the extent that the unit holder receives a replacement unit in exchange. The roll-over also provides that the cost base and reduced cost base of each new unit is based on those of the original units at the time of the roll-over.

23. Roll-over will be available for a SEF unit holder if certain conditions are satisfied.

Requirements for scrip for scrip roll-over – Subdivision 124-M

24. Subdivision 124-M of the ITAA 1997 contains a number of conditions for, and exceptions to, the eligibility of a unit holder to choose scrip for scrip roll-over. The main conditions and exceptions that are relevant to the circumstances of the arrangement that is the subject of this Ruling are outlined below.

Units are exchanged for units in another trust

25. Subparagraph 124-781(1)(a)(i) of the ITAA 1997 requires an entity (a SEF unit holder) to exchange a unit in a trust for a unit in another trust.

26. This requirement will be satisfied because the SEF unit holder will exchange each of their units in SEF for units in WAEV.

Entities have fixed entitlements to all of the income and capital of both trusts

27. Paragraph 124-781(1)(b) of the ITAA 1997 requires that entities have fixed entitlements to all of the income and capital of the original entity (SEF) and the acquiring entity (WAEV).

28. Having regard to:

- (a) all of the documents and any other material referred to in paragraph 13 of this Ruling; and
- (b) all the facts comprising the Scheme as described in paragraphs 13 to 17 of this Ruling,

it is considered that, for the purposes of paragraph 124-781(1)(b) of the ITAA 1997, there are fixed entitlements to all of the income and capital of SEF and WAEV immediately before, during and immediately after the Scheme that is the subject of this Ruling.

The exchange occurs as part of an arrangement that satisfies the conditions in subsection 124-781(2)

80% ownership

29. Paragraphs 124-781(1)(c) and 124-781(2)(a) of the ITAA 1997 require that the exchange of units is in consequence of an arrangement that results in the acquiring entity (WAEV) becoming the owner of 80% or more of the trust voting interests in the original entity (SEF), or if there are none, 80% of the units or other interests in the original entity.

30. A trust voting interest is defined in subsection 124-781(6) of the ITAA 1997 as an interest that confers rights of the same or a similar kind as the rights conferred by a voting share in a company. 'Voting shares' are defined in subsection 995-1(1) of the ITAA 1997 by reference to the definition in section 9 of the *Corporations Act 2001*.

31. This requirement will be satisfied. All of the SEF units are trust voting interests as defined in subsection 995-1(1) of the ITAA 1997. As a consequence of the offer made on 14 November 2006, WAEV will become the owner of 100% of the SEF units.

All voting interest owners participate

32. Paragraphs 124-781(1)(c) and 124-781(2)(b) of the ITAA 1997 require that the exchange of units is in consequence of an arrangement in which at least all owners of trust voting interests (or units or other interests) in the original entity (SEF) could participate.

33. This requirement is satisfied because the offer by WAEV was made to all unit holders in SEF.

Participation is on substantially the same terms

34. Paragraphs 124-781(1)(c) and 124-781(2)(c) of the ITAA 1997 require that the exchange of units is in consequence of an arrangement in which participation was available on substantially the same terms for all of the owners of units of a particular type.

35. At the implementation date, which is expected to be 10 February 2007, SEF will have only one class of units: capital units entitling unit holders to both capital and income. This condition will be satisfied because the same offer was made to all SEF capital unit holders and therefore all capital unit holders will exchange their units on the same terms. Each SEF unit holder will receive the same consideration for each SEF unit disposed of.

Conditions for the roll-over

36. Paragraph 124-781(1)(d) of the ITAA 1997 requires that the conditions for roll-over outlined in subsections 124-781(3) and (4) of the ITAA 1997 are satisfied.

37. The conditions in subsections 124-781(3) and (4) of the ITAA 1997 are set out in paragraphs 38 to 49 of this Ruling.

The SEF interests are post CGT units

38. Paragraph 124-781(3)(a) of the ITAA 1997 requires that the original interest holder acquired its interest on or after 20 September 1985.

39. This requirement will be satisfied as SEF was established on 21 November 1996.

The SEF interest owners would otherwise make a capital gain

40. Paragraph 124-781(3)(b) of the ITAA 1997 requires that apart from the roll-over, the original interest holder (a SEF unit holder) would make a capital gain from a CGT event happening in relation to its original interest

41. Whether a SEF unit holder would make a capital gain apart from the roll-over is dependent on the specific circumstances of each unit holder including the unit holder's cost base of each SEF unit at the time of disposal and the value of the capital proceeds received.

42. Roll-over is not available if, in respect of a SEF unit, a unit holder would make a capital loss.

A SEF unit holder can choose scrip for scrip roll-over

43. Paragraph 124-781(3)(c) of the ITAA 1997 requires that the original interest holder chooses to obtain roll-over, or if section 124-782 of the ITAA 1997 applies to it for the Scheme, SEF and the replacement entity jointly choose to obtain roll-over.

Further conditions are not applicable

44. Subsection 124-781(4) of the ITAA 1997 provides additional requirements to be satisfied if the original interest holder (a SEF unit holder) and the trustee of the acquiring entity did not deal with each other at arm's length, and neither the original entity nor the acquiring entity had at least 300 beneficiaries just before the arrangement started. The additional requirements are:

- (a) the market value of the original interest holder's capital proceeds for the exchange must be at least substantially the same as the market value of its original interest; and
- (b) the replacement interest must carry the same kind of rights and obligations as those attached to the original interest.

45. Subsection 995-1(1) of the ITAA 1997 provides:

arm's length: in determining whether parties deal at arm's length, consider any connection between them and any other relevant circumstance.

46. Paragraph 60 of Taxation Ruling TR 2005/19 states that the fact that there is no ownership connection between the parties is not determinative, on its own, of whether the parties deal with each other at arm's length. The question is whether the parties dealt with each other at arm's length; *The Trustees for the Estate of the late AW Furse No 5 Trust v. FC of T 91* ATC 4007 at 4014 -4015; (1990) 21 ATR 1123 at 1132. This will be determined by considering the terms of the dealing and any other relevant consideration.

47. *Black's Law Dictionary* defines 'arm's length' as 'beyond the reach of personal influence or control' and adds that '[p]arties are said to deal with at arm's length when each other stands upon the strict letter of his rights, and conducts the business in a formal manner, without trusting the other's control or overmastering influence.'

48. The applicant has advised that both SEF and WAEV are registered managed investment schemes (RMIS) pursuant to section 601EA of the *Corporations Act 2001*. Under the Corporations Act, a RMIS is required to have a responsible entity.

49. NMFM is the trustee, and the responsible entity, for both SEF and WAEV. Section 601FC of the *Corporations Act 2001* lists the duties of a responsible entity. As responsible entity, amongst other duties, NMFM is required to act honestly and exercise the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position; and act in the best interest of members, and if there is a conflict between the members' interest and its own interests, give priority to the members interests. The responsible entity is also required to report to ASIC any breach of this Act. Therefore it is considered that the parties are duty bound to act at arm's length and the additional requirement in paragraphs 124-781(4)(a) and (b) will not apply.

Exceptions to obtaining scrip for scrip roll-over are not applicable

Roll-over is not available if any of the exceptions in section 124-795 apply

50. Section 124-795 of the ITAA 1997 contains a number of exceptions where scrip for scrip roll-over cannot be chosen. The exceptions in section 124-795 are as follows.

(a) SEF unit holders are residents of Australia

51. Subsection 124-795(1) of the ITAA 1997 provides that a roll-over is not available, if just before the disposal, the original interest holder was a foreign resident unless, just after the acquisition of the replacement interest, the replacement entity is an Australian resident.

52. The class of entities to whom this ruling applies is limited to SEF unit holders who are residents of Australia at the time of the Scheme. As a consequence, the exception in subsection 124-795(1) of the ITAA 1997 will not apply to limit this ruling in this regard.

(b) A capital gain cannot (apart from a roll-over) be otherwise disregarded

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

54. Whether the capital gain arising because of the disposal of a SEF unit is disregarded under another provision of the ITAA 1997 (for example the unit holder holds their SEF units as trading stock) is a question of fact to be determined in respect of each SEF unit. Paragraph 18 of this Ruling limits this Ruling in this regard.

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

56. This exception will not apply because WAEV is not a foreign resident trust.

(c) No roll-over is available to SEF unit holders under either Division 122 or Subdivision 124-G

57. Subsection 124-795(3) of the ITAA 1997 provides that scrip for scrip roll-over is not available if a roll-over can be chosen under Division 122 or Subdivision 124-G of the ITAA 1997.

58. This exception does not apply as neither of the roll-over under Division 122 or Subdivision 124-G of the ITAA 1997 are available to the SEF unit holders in respect of the disposal of their SEF units under the Scheme.

(d) SEF is not a foreign resident

59. Subsections 124-795(4) and (5) of the ITAA 1997 provide that roll-over is not available for certain original entities that are foreign entities.

60. This exception will not apply as SEF (the original entity) is not a foreign resident.

Consequences of choosing roll-over

Capital gain disregarded

61. Scrip for scrip roll-over in Subdivision 124-M of the ITAA 1997 enables a unit holder to disregard all or part of a capital gain from a unit that is disposed of as part of a takeover or merger if the unit holder receives a replacement unit in exchange.

62. If the only capital proceeds the unit holder receives in respect of the disposal are replacement units and the requisite conditions are satisfied, the capital gain is disregarded completely (subsection 124-785(1) of the ITAA 1997).

63. Under the Scheme, SEF unit holders will only receive WAEV units in respect of the disposal of their SEF units. Further, SEF unit holders will not receive any ineligible proceeds (for the purposes of subsection 124-790(1) of the ITAA 1997) under the Scheme. As a consequence, SEF unit holders who choose scrip for scrip roll-over will disregard the entire amount of the capital gain made under CGT event A1 which happens on the disposal of their SEF units.

Cost base of WAEV units***If scrip for scrip roll-over is chosen***

64. Subsections 124-785(2) and (4) of the ITAA 1997 require that where scrip for scrip roll-over is chosen, the first element of the cost base and the reduced cost base of each unit received as a result of an exchange is determined by reasonably attributing to it the cost base of the original interest for which it was exchanged.

65. Therefore, where scrip for scrip roll-over is chosen, the first element of the cost base and the reduced cost base of the replacement WAEV units that a SEF unit holder receives will be the cost base of the corresponding SEF unit which was exchanged.

66. As SEF unit holders will not receive any ineligible proceeds under the Scheme, subsection 124-785(3) of the ITAA 1997 will not apply to reduce the amount of cost base of their original SEF units that can be attributed to the replacement WAEV units.

If scrip for scrip roll-over is not, or cannot, be chosen

67. Subsection 110-25(2) of the ITAA 1997 provides that the first element of the cost base of an asset is the total of:

- the money you paid or are required to pay in respect of acquiring it; and
- the market value of any other property given or required to be given in respect of acquiring it.

The market value of the property is worked out at the time of the acquisition.

68. For SEF unit holders who do not, or cannot, choose scrip for scrip roll-over, the first element of the cost base and reduced cost base of their WAEV units is determined by the market value of the SEF units they disposed of under the Scheme.

Acquisition date of the WAEV units

69. The acquisition date of the WAEV units is the date they are acquired (this is the Implementation Date) for each SEF unit holder (section 109-10 of the ITAA 1997).

70. For SEF unit holders who choose to obtain scrip for scrip roll-over, the acquisition date of their WAEV units for CGT discount purposes will be the date they acquired their original SEF units which were disposed of in exchange for the relevant WAEV units (item 2 of the table in subsection 115-30(1) of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations

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Subject references:

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- CGT assets
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- CGT replacement assets
- fixed entitlements
- fixed trust
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- unitholder
- unit trust

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 95(2)
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 109-10
- ITAA 1997 110-25(2)
- ITAA 1997 115-30(1)
- ITAA 1997 116-20(1)
- ITAA 1997 Div 122
- ITAA 1997 Subdiv 124-G
- ITAA 1997 Subdiv 124-M
- ITAA 1997 124-781(1)(a)(i)
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- ITAA 1997 124-782
- ITAA 1997 124-785(1)
- ITAA 1997 124-785(2)
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- ITAA 1997 124-785(4)
- ITAA 1997 124-790(1)
- ITAA 1997 124-795
- ITAA 1997 124-795(1)
- ITAA 1997 124-795(2)(b)
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- ITAA 1997 124-795(4)
- ITAA 1997 995-1
- ITAA 1997 995-1(1)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001 9
- Corporations Act 2001 601EA
- Corporations Act 2001 601FC

Case references:

- The Trustee for the Estate of the late AW Furse No. 5 Will Trust v. FC of T 91 ATC 4007; (1990) 21 ATR 1123

ATO references

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