



CR 2010/46 - Income tax: capital gains tax: conversion of Abalone Fishermen's Co-operative Limited to a company registered under the Corporations Act 2001

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Class Ruling

Income tax: capital gains tax: conversion of Abalone Fishermen's Co-operative Limited to a company registered under the *Corporations Act 2001*

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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.

[Note: *This is a consolidated version of this document. Refer to the ATO Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

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 provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 124-520 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 725 of the ITAA 1997; and
- Division 727 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies comprises members of Abalone Fishermen's Co-operative Limited (Abalone Co-operative):

- (a) whose shares will be cancelled and replaced with new shares in AFCOL Australia Limited (AFCOL) as a result of the Abalone Co-operative's registration as a company (Conversion) under the *Corporations Act 2001* (the Corporations Act); and
- (b) who are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Abalone Co-operative shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme 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 9 to 44 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 from 6 June 2010 to 30 June 2012. The Ruling continues to apply after 30 June 2012 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant. The following documents or relevant parts of them form part of and are to be read with the description:

- application for Class Ruling on behalf of the Abalone Co-operative dated 21 January 2010;
- copy of the Draft Constitution of AFCOL;
- rules of the Abalone Co-operative;
- response to request for further information dated 2 June 2010; and
- other correspondence and e-mails from the applicant in relation to the application for class ruling.

The Abalone Co-operative

10. The Abalone Co-operative (also known as Mallacoota Co-op) is an entity incorporated and regulated by the *Co-operatives Act 1996* (Vic) (Co-operatives Act). It was established on 23 February 1968 by a group of abalone divers operating in Victoria's Eastern Zone abalone fishery.

11. All members of the Abalone Co-operative must be active members of the Abalone Co-operative. Active members are those who sell at least 90% of their abalone catch during any month in which the Abalone Co-operative buys every day.

12. If a member fails or ceases to be an active member, the board must within the time allowed under the Co-operatives Act and the rules of the Abalone Co-operative:

- declare the membership of that member cancelled; and
- forfeit the shares of the member.

13. Therefore, the Abalone Co-operative can potentially have three types of members:

- (i) active members who sell at least 90% of their abalone catch to the Abalone Co-operative;
- (ii) non-active members who have previously met the requirement to sell 90% of their catch to the Abalone Co-operative but no longer do so.

Section 131 of the Co-operatives Act, in conjunction with the rules of the Abalone Co-operative, requires the cancellation of the membership and forfeiture of shares of members who have not been active for three years. The amount paid up on the shares is repaid on forfeiture; and

- (iii) former members who have had their shares forfeited by the Abalone Co-operative.

Under section 143 of the Co-operatives Act, former members who have had their shares forfeited may acquire a right to be issued with shares in the converted company upon conversion, if a special resolution to convert the co-operative is passed within five years of that date of forfeiture.

14. Active members and non-active members have shares and membership rights.

Shares

15. According to the rules of the Abalone Co-operative every member must hold shares. The nominal value per share is \$2.00 and the shares are fully paid up. There is no share premium account amount.

16. Application for membership must include an application for at least one share in the Abalone Co-operative.

17. Capital of the Abalone Co-operative is raised by the issue of shares.

18. A share can only be transferred, with the consent of the board, to a person who is qualified to be admitted to membership of the Abalone Co-operative; or as otherwise provided by the rules of the Abalone Co-operative or the Co-operatives Act.

19. Non-active members' shares will be cancelled and forfeited. Although forfeited, a member remains liable to pay any amount still unpaid at the date of forfeiture in respect of those shares.

Voting rights

20. Only an active member of the Abalone Co-operative is entitled to vote at meetings, and each member has only one vote at a meeting.
21. A member who is under 18 years of age is not entitled to vote.
22. Joint members have only one vote, which may be exercised by the member whose name appears first in the register of members unless directed otherwise by the other joint member.
23. A question for decision at a general meeting, other than a special resolution, must be determined by a majority of the members present and voting at the meeting.

Abalone Co-operative members

24. The Abalone Co-operative currently has 19 active members and one non-active member who hold between them 187,376 shares of which 112,425 (60% of the issued shares) are pre-CGT shares.
25. The largest shareholder in the Abalone Co-operative has 10,567 shares being 5.6% of the issued capital. The minimum number of shares issued is 8,170 being 4.3% of issued capital.
26. No member holds more than 20% of the issued capital of the Abalone Co-operative.
27. All members are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936.
28. Immediately before the Conversion no member of the Abalone Co-operative directly or indirectly with or without associates will hold collectively:
- (i) a 50% stake – that is, can exercise, or can control the exercise of at least 50% of the voting power in the Abalone Co-operative, or have rights to receive at least 50% of any dividends that the Abalone Co-operative may pay or have the right to receive at least 50% of any distribution of capital of the Abalone Co-operative (subsection 727-355(1));
 - (ii) a 40% stake – that is, can exercise, or can control the exercise of at least 40% of the voting power in the Abalone Co-operative, or have the right to receive at least 40% of the dividends that the Abalone Co-operative may pay, or have the right to receive at least 40% of any distribution of capital of the Abalone Co-operative (subsection 727-355(2)); or
 - (iii) actual control – that is, the entity, either alone or together with its associates in fact controls the Abalone Co-operative (subsection 727-355(3)).

Conversion of the co-operative to a company

29. The Board of Directors of the Abalone Co-operative will prepare a Disclosure Statement for approval by the Registrar of Co-operatives which will then be forwarded to members before a vote on the Conversion from a co-operative to a company.

30. The proposal will have to be approved by the members by a special resolution passed in accordance with the Co-operatives Act.

31. On obtaining the necessary approvals, application will be made to the Australian Securities and Investment Commission for the Abalone Co-operative to be registered under the Corporations Act with a new name, AFCOL Australia Limited and a constitution approved by the members of the Abalone Co-operative. The Abalone Co-operative will cease to be registered as a co-operative when the company is registered.

32. The members of the Abalone Co-operative will have their shares in the Abalone Co-operative cancelled and will be issued with new shares in AFCOL on a one for one basis just before the Conversion.

33. AFCOL will issue two classes of shares:

- abalone supplier class shares will be issued to active members; and
- non-supplier class shares will be issued to non-active members.

34. The issue of abalone supplier class shares and non-supplier class shares in AFCOL will so far as possible replicate the voting, dividend and winding up rights of the various categories of members of Abalone Co-operative.

35. Upon the Conversion, each member of the Abalone Co-operative will be issued with abalone supplier class or non-supplier class shares equal to the value of shares held by them in the Abalone Co-operative and paid up to \$2.00 each.

36. The proposed constitution of AFCOL provides that there must be a minimum of three directors who hold abalone supplier class shares. Non-supplier shareholders may elect at least one of their members to the Board, if they collectively hold at least 20% of share capital. Alterations to the constitution must be approved by at least a 75% majority of the holders of abalone supplier class shares.

37. In accordance with subsection 310(3) of the Co-operatives Act, the Conversion of Abalone Co-operative from a co-operative to a company must result in every member who holds shares in the Abalone Co-operative at the date of Conversion being the holder of shares in the company equal in number and nominal value to their shares in the Abalone Co-operative. On Conversion, the assets of the Abalone Co-operative will form the assets of AFCOL. The assets of the Abalone Co-operative will not be diminished by the Conversion.

38. Under the proposed constitution of AFCOL, if a holder of an abalone supplier class share ceases to be an abalone supplier, the abalone supplier class shares held may be converted to non-supplier class shares. Conversely, if a holder of non-supplier class shares becomes an abalone supplier, the shares may be converted into abalone supplier class shares.

39. No provision is made in the constitution of AFCOL for the automatic forfeiture of shares.

40. AFCOL may, from time to time, conduct share buy backs to give the holders of non-supplier class shares the opportunity to exit their shareholdings.

41. All shareholders of AFCOL will have the same dividend rights.

42. All shareholders of AFCOL will be entitled to vote at meetings of members of AFCOL, holding one vote per shareholder on a show of hands or one vote per share on a poll.

43. The Abalone Co-operative has some limited obligations imposed among their members (especially in voting rights). These are features common to entities given their different statutory treatment under the Co-operatives Act and the Corporations Act.

44. The aim of the proposed Conversion includes:

- the retention of the co-operative attributes that underlie the Abalone Co-operative;
- to create a permanent share capital base to support the development and growth of the business;
- to ensure that management control remains with the active abalone supplier members;
- to allow one vote per share but restrict the ability of non-supplier members to change the rules or control the Board in the absence of the agreement of the abalone supplier members;
- to facilitate the introduction of new suppliers;
- to purchase additional quota;
- to facilitate the raising of additional capital by such measures as the introduction of new equity members;
- to overcome the accounting treatment of co-operative shares as liabilities in accordance with the Australian International Financial Reporting Standards; and
- to secure a long term customer base.

Ruling

Capital gains tax

45. Members of the Abalone Co-operative can choose roll-over under section 124-520 for the ending of their shares in the Abalone Co-operative at the time of the Conversion.

Value shifting provisions

46. For the members of Abalone Co-operative, the scheme involving the Conversion of the Abalone Co-operative to AFCOL is not one to which any of the consequences in Division 725 or Division 727 will apply.

Assessable dividend

47. The proposed Conversion will not result in an assessable dividend, as defined in subsection 6(1) of the ITAA 1936 for the members who are within the class of entities mentioned in paragraph 3 of this Ruling.

Commissioner of Taxation

1 September 2010

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.*

Subdivision 124-I roll-over

48. Subdivision 124-I allows a member of a body that is incorporated under a law other than the Corporations Act or a similar foreign law (the Company Law) to choose roll-over for a CGT event that happens when the incorporated body converts to a company incorporated under the Company Law without creating a new legal entity. The conditions for roll-over are listed in subsection 124-520(1).

Conditions for roll-over

49. CGT event C2 in section 104-25 will happen when a member's share in the Abalone Co-operative ends by cancellation on the Conversion. Members of the Abalone Co-operative will be able to choose to obtain roll-over relief under section 124-520 when their share is cancelled.

50. Paragraph 124-520(1)(a) requires that the member choosing roll-over is a member of a body that is incorporated under a law other than the Company Law.

51. This requirement is satisfied as the Abalone Co-operative is incorporated under the Co-operatives Act.

52. Paragraph 124-520(1)(b) of the ITAA 1997 requires that the body is converted into a company incorporated under the Company Law (without creating a new legal entity). The Explanatory Memorandum to the Taxation Laws Amendment Bill 1990, which introduced former section 160ZZPH of the ITAA 1936, the predecessor to section 124-520 of the ITAA 1997, states:

This requirement will ... usually be satisfied where a law under which the incorporation as a company is to occur specifically provides for the legal succession of the company as successor to the former entity.

53. This condition will be satisfied when the Abalone Co-operative is registered as a company under the Corporations Act. Under paragraph 601BM(1)(a) of the Corporations Act and subsection 312(1) of the Co-operatives Act, the incorporation does not create a new legal entity.

54. The condition in paragraph 124-520(1)(c) requires that a company issues shares to members (and nothing else) in substitution for their interest in the body just before the Conversion.

55. This condition will be satisfied when AFCOL issues shares to the members of the Abalone Co-operative (and nothing else) in substitution for their interest in the Abalone Co-operative just before the Conversion. Each member of the Abalone Co-operative will receive only shares in AFCOL in substitution for their interests in the Abalone Co-operative.

56. Paragraph 124-520(1)(d) requires that there is no significant difference between:

- (i) the ownership of the body just before the Conversion and the ownership of the company just after the Conversion; or
- (ii) the mix of ownership of the body just before the Conversion and the mix of the ownership of the company just after the Conversion.

57. Subparagraph 124-520(1)(d)(i) will be satisfied on the facts of this scheme. Just before the Conversion, the owners of the Abalone Co-operative are the members who hold shares in the Abalone Co-operative. The owners of AFCOL just after the Conversion will be those members of the Abalone Co-operative who will be issued with shares, just before the Conversion.

58. Subparagraph 124-520(1)(d)(ii) will be satisfied on the facts of this scheme. The replacement company shares in AFCOL will be issued to members of the Abalone Co-operative in the same number as those held in the Abalone Co-operative. The class of shares in AFCOL (abalone supplier and non-supplier shares) is reflective of the type of membership interest (active and non-active) in the Abalone Co-operative.

59. The change in voting interests between the Abalone Co-operative (one vote per member required by section 180(1) of the Co-operatives Act) and the AFCOL (one vote per share) will not cause a significant difference to the mix of ownership of the Abalone Co-operative just before the Conversion and the mix of ownership of the company just after the Conversion.

60. In view of the totality of the facts of this scheme, involving the Conversion of a co-operative to a company registered under the Corporations Act, and the requirements of the different statutory regimes reflect the differences in voting rights that are not significant for the purposes of subparagraph 124-520(1)(d)(ii).

61. Paragraph 124-520(1)(e) of the ITAA 1997 requires that, at the time of Conversion, either the member is an Australian resident as defined in subsection 6(1) of the ITAA 1936 or the interest in the body for which roll-over is sought is taxable Australian property just before the time of Conversion and the shares are taxable Australian property.

62. This requirement is satisfied as all members of the Abalone Co-operative are residents of Australia.

Consequences if Subdivision 124-I roll-over is chosen

63. The consequences of a choice being made to apply the roll-over in Subdivision 124-I are set out in Subdivision 124-A:

- For a member that holds Abalone Co-operative shares acquired before 20 September 1985, the new AFCOL shares issued in exchange for the pre-CGT Abalone Co-operative shares are taken to have been acquired before that day; and
- For a member that holds Abalone Co-operative shares acquired on or after 20 September 1985, a capital gain or capital loss made on the ending of those shares is disregarded. The first element of the cost base and reduced cost base of the new AFCOL shares will be worked out by apportioning the sum of the cost bases of the Abalone Co-operative shares that have ended over the new AFCOL shares.

Value shifting consequences

64. There can be capital gains tax and income tax consequences where there is a direct value shift as defined in section 725-145 or an indirect value shift as defined in section 727-150. However, there are only consequences where threshold control tests are satisfied.

65. The direct value shifting rules in Division 725 do not apply unless there is an entity that controls (for value shifting purposes) the target entity at some time during a scheme period (paragraph 725-50(b) and section 725-55).

66. The indirect value shifting rules in Division 727 do not apply unless the entities between which value is shifted (the losing entity and the gaining entity) satisfy an ultimate controller test or a common ownership nexus test (paragraph 727-100(c) and sections 727-105 and 727-110).

67. There are no consequences for any direct value shift or indirect value shift that happens under the scheme involving the Conversion of Abalone Co-operative to AFCOL.

68. There would be no consequences for any direct value shift as there is no entity that controls (for value shifting purposes) Abalone Co-operative or (when converted) AFCOL at any time from when the scheme is entered into until when it is carried out (paragraph 725-50(b) and section 725-55).

69. There would be no consequences for any indirect value shift as no entity that provides economic benefits to AFCOL, or receives such economic benefits in return, would, together with Abalone Co-operative or (when converted) AFCOL meet the ultimate controller test or common-ownership nexus test (paragraphs 727-100(c) and 727-110(1)(a), sections 727-105 and 727-355).

Assessable dividend

70. Subsection 6(1) of the ITAA 1936 defines 'dividend' for the purposes of the income tax legislation to include:

- (a) any distribution made by a company to any of its shareholders, whether in money or other property; and
- (b) any amount credited by a company to any of its shareholders as shareholders.

71. The issue by AFCOL of shares to members upon Conversion will not involve a distribution of money or property of AFCOL to the shareholders as the number and nominal value of the shares to be issued corresponds to their holding in the Abalone Co-operative prior to Conversion.

72. No amount is credited to any of the shareholders in their capacity as shareholders.

73. As the Conversion does not involve either a distribution of money or property of the company to the shareholders or an amount being credited by the company to any of its shareholders as shareholders, the issue of shares in AFCOL will not constitute a dividend.

Appendix 2 – Detailed contents list

74. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- assessable income
- capital gain
- CGT event
- CGT roll-over
- control test
- co-operative company
- distribution
- dividends
- incorporation
- ordinary income
- share capital
- shareholders
- shares

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 160ZZPH
- ITAA 1997
- ITAA 1997 104-25
- ITAA 1997 Subdiv 124-A
- ITAA 1997 Subdiv 124-I
- ITAA 1997 124-520
- ITAA 1997 124-520(1)
- ITAA 1997 124-520(1)(a)
- ITAA 1997 124-520(1)(b)
- ITAA 1997 124-520(1)(c)

- ITAA 1997 124-520(1)(d)
- ITAA 1997 124-520(1)(d)(i)
- ITAA 1997 124-520(1)(d)(ii)
- ITAA 1997 124-520(1)(e)
- ITAA 1997 Div 230
- ITAA 1997 Div 725
- ITAA 1997 725-50(b)
- ITAA 1997 725-55
- ITAA 1997 725-145
- ITAA 1997 Div 727
- ITAA 1997 727-100(c)
- ITAA 1997 727-105
- ITAA 1997 727-110
- ITAA 1997 727-110(1)(a)
- ITAA 1997 727-150
- ITAA 1997 727-355
- ITAA 1997 727-355(1)
- ITAA 1997 727-355(2)
- ITAA 1997 727-355(3)
- Corporations Act 2001
- Corporations Act 2001 601BM(1)(a)
- Co-operatives Act 1996 (Vic)
- Co-operatives Act 1996 (Vic) 131
- Co-operatives Act 1996 (Vic) 143
- Co-operatives Act 1996 (Vic) 180(1)
- Co-operatives Act 1996 (Vic) 310(3)
- Co-operatives Act 1996 (Vic) 312(1)
- TAA 1953
- Copyright Act 1968

Other references:

- The Explanatory Memorandum to the Taxation Laws Amendment Bill 1990

ATO references

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