


CR 2010/70 - Income tax: itX Group Limited Scheme of Arrangement and proposed Agreed Dividend

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Class Ruling

Income tax: itX Group Limited Scheme of Arrangement and proposed Agreed Dividend

| | |
|--------------------------------------|-----------|
| Contents | Para |
| LEGALLY BINDING SECTION: | |
| What this Ruling is about | 1 |
| Date of effect | 10 |
| Scheme | 11 |
| Ruling | 27 |
| NOT LEGALLY BINDING SECTION: | |
| Appendix 1: | |
| <i>Explanation</i> | 38 |
| Appendix 2: | |
| <i>Detailed contents list</i> | 74 |

① 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, 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.

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:

- Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 177E of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 177F of the ITAA 1936;
- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 115 of the ITAA 1997;
- section 116-20 of the ITAA 1997; and
- section 204-30 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies, in relation to the application of Part 3-1 and Part 3-3 of the ITAA 1997, consists of the shareholders of itX Group Limited (itX)(itX Shareholders) who:

- (a) are a 'resident of Australia' within the meaning of subsection 6(1) of the ITAA 1936;
- (b) participate in the scheme; and
- (c) hold their shares on capital account.

4. The class of entities to which this Ruling applies for other provisions of the ITAA 1997 and ITAA 1936 consists of all itX shareholders who participate in the scheme.

5. This Ruling does not apply to itX shareholders who are subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their itX shares.

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

Qualifications

6. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

7. 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 11 to 26 of this Ruling.

8. 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

10. This Ruling applies from 1 July 2010 to 30 June 2011. The Ruling continues to apply after 30 June 2011 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

11. 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:

- Class Ruling application from Deloitte Touche Tohmatsu Ltd (Deloitte) dated 14 September 2010;
- the Scheme Implementation Agreement, together with its annexures, between Avnet Technology Solutions (Australia) Pty Ltd (Avnet Technology Solutions) and itX, dated 16 October 2010;
- the Scheme Booklet released on 20 October 2010; and
- correspondence from Deloitte dated 13 October 2010 and 10 November 2010.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

itX

12. itX is a public company limited by shares and listed on the Australian Securities Exchange (ASX).

13. itX has a single class share capital structure with 50,000,000 ordinary shares on issue (as at the date of the Scheme Implementation Agreement).

Avnet and Avnet Technology Solutions

14. Avnet, Inc. (Avnet) is listed on the New York Stock Exchange.

15. Avnet Technology Solutions is a proprietary company registered in Australia and is limited by shares and is a wholly owned subsidiary of Avnet.

16. Avnet and Avnet Technology Solutions do not presently own any shares in itX (either directly or through wholly owned subsidiaries).

The Scheme of Arrangement

17. On 16 October 2010, itX and Avnet announced that they had signed a Scheme Implementation Agreement (SIA) under which Avnet, via its subsidiary Avnet Technology Solutions, proposes to acquire all of the issued shares in itX by way of a court ordered Scheme of Arrangement pursuant to Part 5.1 of the *Corporations Act 2001* (the Scheme).

18. The Scheme is subject to approval by itX Shareholders and the Court.

19. The Scheme Record Date for the acquisition of the itX shares is 17 December 2010 and the Scheme will be implemented by 4 January 2011.

20. Avnet and Avnet Technology Solutions will pay the Scheme Consideration to itX Shareholders for the transfer of their itX shares. The Scheme Consideration is \$1.55 cash, reduced by the Agreed Dividend if declared and paid in accordance with the SIA, in respect of each itX share held by an itX Shareholder.

21. When the Scheme is implemented, itX will become a wholly-owned subsidiary of Avnet and will be delisted from the ASX.

Payment of the Agreed Dividend

22. The SIA allows itX to declare and pay an Agreed Dividend of up to \$0.20 per itX share subject to certain conditions being met.

23. The declaration and payment of the Agreed Dividend will be subject to itX's normal dividend declaration and payment process and is not subject to any consents being granted by Avnet and Avnet Technology Solutions. It is intended that any Agreed Dividend will be fully franked and will be debited against itX's retained profits account.

24. The Agreed Dividend will be funded from existing cash reserves or, if necessary, by drawing down on existing loan facilities. itX will not fund the Agreed Dividend through loans from Avnet or Avnet Technology Solutions and will not receive any other financial assistance (for example, in the form of indemnities or guarantees) from Avnet or Avnet Technology Solutions.

25. The Agreed Dividend will only be paid if the scheme is approved by itX shareholders and by the Court. Pursuant to the SIA, the Scheme Consideration will be reduced by any amount of Agreed Dividend declared and paid.

26. The Dividend Record Date for the Agreed Dividend will be 14 December 2010.

Ruling

Capital Gains Tax (CGT)

CGT event A1

27. CGT event A1 will happen when an itX Shareholder disposes of each of their itX shares to Avnet Technology Solutions pursuant to the Scheme (subsections 104-10(1) and (2) of the ITAA 1997).

28. The time of the CGT event will be the Scheme Implementation Date when the change of ownership occurs (paragraph 104-10(3)(b) of the ITAA 1997).

29. An itX Shareholder will make a capital gain when CGT event A1 happens if the capital proceeds in respect of the disposal of an itX share exceed its cost base. An itX Shareholder will make a capital loss if the capital proceeds in respect of the disposal of an itX share are less than its reduced cost base (subsection 104-10(4) of the ITAA 1997).

Capital proceeds

30. The capital proceeds from the disposal will be the money received or entitled to be received by itX Shareholders for each of their itX shares (subsection 116-20(1) of the ITAA 1997). The capital proceeds will not include the Agreed Dividend.

Discount capital gain

31. If an itX Shareholder makes a capital gain from the disposal of an itX share, the itX Shareholder may be eligible to treat the capital gain as a discount capital gain provided that all relevant requirements of Division 115 of the ITAA 1997 are satisfied.

Qualified persons

32. The payment of the Agreed Dividend by itX will constitute a related payment for the purposes of former section 160APHN of the ITAA 1936.

33. Accordingly, each itX shareholder will need to hold their itX shares at risk for a continuous period of at least 45 days in the secondary qualification period in order to be a qualified person in respect of the Agreed Dividend.

34. itX shareholders will no longer be considered to hold their itX shares 'at risk' for the purposes of Division 1A of former Part IIIA of the ITAA 1936 (former Division 1A) as of 17 December 2010, which is the Scheme Record Date. Those itX shareholders who have held their itX shares 'at risk' for a continuous period of not less than 45 days during the period 31 October 2010 to 16 December 2010 will be qualified persons with respect to the Agreed Dividend.

The anti-avoidance provisions

35. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefit received in relation to the Agreed Dividend.

36. The Scheme is not a scheme, or a scheme having substantially the effect of a scheme, by way of, or in the nature of dividend stripping within the meaning of section 177E of the ITAA 1936 and the Commissioner will not make a determination under subsection 177F(1) of the ITAA 1936 to include any amount in the assessable income of itX shareholders.

37. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit received in relation to the Agreed Dividend.

Commissioner of Taxation

1 December 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.*

Capital Gains Tax

CGT event A1

38. CGT event A1 (section 104-10 of the ITAA 1997) happens if there is a change in the ownership of an asset from one entity to another. This 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 (paragraph 104-10(3)(b) of the ITAA 1997).

39. CGT event A1 will happen to itX Shareholders when the change of ownership occurs on the Scheme Implementation Date.

40. The time when CGT event A1 happens determines the income year in which any capital gain or loss is made and whether the CGT discount applies to any capital gain (subsection 104-10(3) of the ITAA 1997).

41. An itX Shareholder will make a capital gain from CGT event A1 happening if the capital proceeds from the disposal of an itX share exceed its cost base. An itX Shareholder will make a capital loss if those capital proceeds are less than the itX share's reduced cost base (subsection 104-10(4) of the ITAA 1997).

Capital proceeds

42. The capital proceeds from the disposal will be the money received or entitled to be received by itX Shareholders for each of their itX shares (subsection 116-20(1) of the ITAA 1997). The capital proceeds will not include the Agreed Dividend.

Discount capital gain

43. If an itX Shareholder makes a capital gain from the disposal of an itX share, the itX Shareholder may be eligible to treat the capital gain as a discount capital gain provided that all relevant requirements of Division 115 of the ITAA 1997 are satisfied.

Qualified persons

44. Former Division 1A contains the measures known as the holding period rule and the related payment rule. In broad terms, former Division 1A provides the statutory tests that must be satisfied for a taxpayer to be a 'qualified person' with respect to a franked distribution they have received and thus be entitled to a tax offset for the franking credit attached to the distribution.

45. The test of what constitutes a 'qualified person' is provided in former section 160APHO of the ITAA 1936 as follows:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a **qualified person** in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of a taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification in relation to the dividend.

46. Former subsection 160APHO(2) of the ITAA 1936, referred to in the preceding paragraph, sets out the holding period requirement. Broadly, if a taxpayer is not under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer will have to satisfy the holding period requirement within the primary qualification period. If a taxpayer is under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer will have to satisfy the holding period requirement within the secondary qualification period.

Related payment rule

47. In order to determine which is the relevant qualification period, it is necessary to determine whether, under the present arrangement, the itX shareholders are considered to be under an obligation to make a related payment.

48. Former section 160APHN of the ITAA 1936 provides non-definitive examples of what constitutes the making of a related payment for the purposes of former Division 1A. Former subsection 160APHN(2) of the ITAA 1936 provides:

The taxpayer or associate is taken, for the purposes of this Division, to have made, to be under an obligation to make, or to be likely to make, a related payment in respect of the dividend or distribution if, under an arrangement, the taxpayer or associate has done, is under an obligation to do, or may reasonably be expected to do, as the case may be, anything having the effect of passing the benefit of the dividend or distribution to one or more other persons.

49. Former subsection 160APHN(3) of the ITAA 1936 states:

Without limiting subsection (2), the doing of any of the following by the taxpayer or an associate of the taxpayer in the circumstances mentioned in subsection (4) may have the effect of passing the benefit of the dividend or distribution to one or more other person:

- (a) causing a payment or payments to be made to, or in accordance with the directions of, the other person or other persons; or
- (b) causing an amount or amounts to be credited to, or applied for the benefit of, the other person or the other persons; or

- (c) causing services to be provided to, or in accordance with the directions of, the other person or other persons; or
- (d) causing property to be transferred to, or in accordance with directions of, the other person or other persons; or
- (e) allowing any property or money to be used by the other person or other persons or by someone nominated by the other person or other persons; or
- (f) causing an amount or amounts to be set off against, or to be otherwise applied in reduction of, a debt or debts owed by the other person or other persons; or
- (g) agreeing to treat an amount or amounts owed to the other person or other persons by the taxpayer or associate as having been increased.

50. Former subsection 160APHN(4) of the ITAA 1936 states:

The circumstances referred to in subsection (3), are where:

- (a) the amount or the sum of the amounts paid, credited or applied; or
- (b) the value or the sum of the values of the services provided, of the property transferred or of the use of the property or money; or
- (c) the amount or the sum of the amounts of the set-offs, reductions or increases;

as the case may be:

- (a) is, or may reasonably be expected to be, equal to; or
- (b) approximates or may reasonably be expected to approximate; or
- (c) is calculated by reference to;

the amount of dividend or distribution.

51. In the present case, it is considered that the proposed payment of the Agreed Dividend is an integral part of the Scheme. The payment of the Agreed Dividend is conditional upon itX obtaining approval from the itX shareholders at the Scheme Meeting for the itX Scheme to be entered into. As such, the Agreed Dividend is conditional upon the Scheme being approved, tying the payment of the Agreed Dividend to the disposal of the itX shares by itX shareholders to Avnet. Further, the payment of any amount of the Agreed Dividend by itX has the effect of reducing the Scheme Consideration an itX shareholder will receive from Avnet by the amount of the Agreed Dividend.

52. In these circumstances, in determining whether an itX shareholder is taken to have made or be likely to make a related payment in respect of the Agreed Dividend, it is considered that the circumstances surrounding the payment of the Agreed Dividend would constitute an act that passes the benefit to another for the purposes of former subsection 160APHN(3) of the ITAA 1936. As such, it can be concluded that an itX shareholder will be taken to have made or be likely to make a related payment in respect of the Agreed Dividend.

Holding period requirement

53. As the itX shareholders are taken, for the purposes of former Division 1A, to have made or be likely to make a related payment in respect of the Agreed Dividend, the relevant holding period is thus the secondary qualification period pursuant to former paragraph 160APHO(1)(b) of the ITAA 1936.

54. The secondary qualification period is defined in former section 160APHD of the ITAA 1936 as follows:

In relation to a taxpayer in relation to shares or an interest in shares, means:

- (a) if the shares are not preference shares – the period beginning on the 45th day before, and ending on the 45th day after, the day on which the shares or interest becomes ex dividend

55. The ex-dividend date of the Agreed Dividend for tax purposes is 15 December 2010 pursuant to former section 160APHE of the ITAA 1936.

56. The secondary qualification period thus runs from 45 days before the ex-dividend date of 15 December 2010 as determined in paragraph 55 and ends 45 days after that day. In practical terms, this means that the secondary qualification period runs from 31 October 2010 to 29 January 2011. However, pursuant to former subsection 160APHO(3) of the ITAA 1936, any days on which a taxpayer has materially diminished risks of loss or opportunities for gain in respect of the itX shares are to be excluded. This would mean that the secondary qualification period would run from 31 October 2010 until the date that itX shareholders are no longer at risk for the purposes of former Division 1A.

57. In this context, entitlement to participate in the Scheme will be determined on the Scheme Record Date on the basis of being an itX shareholder who is registered in the register as the holder of the relevant Scheme Share on 17 December 2010. It is considered that once an itX shareholder is identified as an itX shareholder, that itX shareholder would no longer be considered to hold their shares 'at risk' for the purposes of former Division 1A as at that time the itX shareholder is committed to disposing of their itX share and receiving the Scheme Consideration.

58. Accordingly, the secondary qualification period would run from 31 October 2010 until 16 December 2010 (inclusive). itX shareholders who receive the Agreed Dividend would need to hold their shares at risk for a continuous period of not less than 45 days during this period in order to be a 'qualified person' for the purposes of former Division 1A. Further, pursuant to former paragraph 160APHO(2)(a) of the ITAA 1936, the date of acquisition or disposal are not included in the relevant 45 day period. This would have the effect in the present circumstances, for example, that the 45 day qualification period could not include 31 October if this was the date of acquisition of itX shares.

The anti-avoidance provisions**Section 204-30**

59. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an imputation benefit is, or apart from this section would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); and
- (c) the other member of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c) of the ITAA 1997).

60. Relevantly, if section 204-30 of the ITAA 1997 applies, the Commissioner is vested with a discretion under subsection 204-30(3) to make a determination in writing either:

- (a) that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a) of the ITAA 1997); or
- (b) that no imputation benefit is to arise in respect of any distributions made to a favoured member and specified in the determination (paragraph 204-30(3)(c) of the ITAA 1997).

61. For section 204-30 of the ITAA 1997 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than the members who consequently do not receive franking credits, or do not receive the same amount of franking credits as they would have had streaming not occurred.

62. Under the current Scheme for the payment of Agreed Dividend all itX shareholders will receive an imputation benefit as a result of the Agreed Dividend; the resident shareholders in the form of a tax offset (paragraph 204-30(6)(a) of the ITAA 1997) and the non-resident shareholders in the form of an exemption from dividend withholding tax (paragraph 204-30(6)(e) of the ITAA 1997). The resident shareholders will derive a greater benefit from franking credits than the non-resident shareholders.

63. However, the Agreed Dividend will be paid to all itX shareholders at the Dividend Record Date and will be fully franked with Australian franking credits. Accordingly, it cannot be argued that itX will direct the flow of distributions in such a manner as to stream the imputation benefits such that one class of members will derive a greater benefit from the franking credits attached to the dividends, while the other members will receive lesser or no imputation benefits.

64. As the conditions in subsection 204-30(1) of the ITAA 1997 for the provision to apply will not be met, the Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefit received in relation to the Agreed Dividend.

Section 177E

65. Section 177E of the ITAA 1936 deals with situations where any property of a company is disposed of as a result of a scheme entered into after 27 May 1981, whether in Australia or outside Australia:

- by way of or in the nature of dividend stripping; or
- having substantially the effect of a scheme by way of or in the nature of a dividend stripping.

66. Having regard to the purpose of the Scheme under which the shareholders will dispose of their itX shares to Avnet, the Scheme will not be a scheme by way of or in the nature of dividend stripping, or a scheme having substantially the effect of a scheme by way of or in the nature of dividend stripping to which section 177E of the ITAA 1936 is applicable.

Section 177EA

67. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes seeking to obtain a tax advantage in relation to imputation benefits. Subsection 177EA(3) provides that section 177EA applies if:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of membership interests, as the case may be;
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit;
- (d) except for this section, a person (the 'relevant taxpayer') would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose, but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

68. If section 177EA of the ITAA 1936 applies, the Commissioner may make a determination under subsection 177EA(5) that either a franking debit arises to the company in respect of each distribution paid to the relevant taxpayer (paragraph 177EA(5)(a)) or, in the alternative, that no franking credit benefit arises in respect of a distribution paid to the relevant taxpayer (paragraph 177EA(5)(b)).

69. In the present case, itX is a corporate tax entity. The disposal of the ordinary shares in itX pursuant to the Scheme is a scheme for the disposition of membership interests. The Agreed Dividend is frankable distributions that will be paid to itX shareholders as a part of this Scheme who could, therefore, reasonably be expected to receive imputation benefits.

70. The conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of itX or its shareholders, there is a purpose, more than merely an incidental purpose, of conferring an imputation benefit under the Scheme.

71. In arriving at a conclusion the Commissioner must have regard to the relevant circumstances of the Scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of circumstances which taken individually or collectively could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may not be present at any one time in any one scheme.

72. The relevant circumstances of the Scheme indicate that there is no requisite purpose of conferring an imputation benefit under the Scheme. The Agreed Dividend will be fully franked, which is a continuation of itX's dividend policy to pay fully franked dividends. itX has only ordinary shares on issue and the dividends have been and will be paid to all itX shareholders on a pro-rata basis in proportion to the number of shares that each itX shareholder holds on the relevant Dividend Record Date. The amount of the Agreed Dividend allows itX shareholders to share in the accumulated profits of itX.

73. In considering the manner, form and substance of the Scheme, it is considered that the Scheme is not being entered into for the purpose of enabling members to obtain an imputation benefit. Having regard to the relevant circumstances of the Scheme, the Commissioner has come to the view that the requisite purpose is not present and accordingly the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit received in relation to the dividends.

Appendix 2 – Detailed contents list

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

| | Paragraph |
|--|------------------|
| What this Ruling is about | 1 |
| Relevant provisions | 2 |
| Class of entities | 3 |
| Qualifications | 6 |
| Date of effect | 10 |
| Scheme | 11 |
| itX | 12 |
| Avnet and Avnet Technology Solutions | 14 |
| The Scheme of Arrangement | 17 |
| Payment of the Agreed Dividend | 22 |
| Ruling | 27 |
| Capital Gains Tax | 27 |
| <i>CGT event A1</i> | 27 |
| <i>Capital proceeds</i> | 30 |
| <i>Discount capital gain</i> | 31 |
| Qualified persons | 32 |
| The anti-avoidance provisions | 35 |
| Appendix 1 – Explanation | 38 |
| Capital Gains Tax | 38 |
| <i>CGT event A1</i> | 38 |
| Capital proceeds | 42 |
| Discount capital gain | 43 |
| Qualified persons | 44 |
| <i>Related payment rule</i> | 47 |
| <i>Holding period requirement</i> | 53 |
| The anti-avoidance provisions | 59 |
| <i>Section 204-30</i> | 59 |
| <i>Section 177E</i> | 65 |
| <i>Section 177EA</i> | 67 |
| Appendix 2 – Detailed contents list | 74 |

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- arrangement
- CGT capital proceeds
- CGT event A1
- company
- dividend
- dividend streaming arrangements
- dividend stripping
- frankable dividends
- franking credits
- holding period
- imputation system
- mergers
- ordinary shares
- qualified person
- related payment

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 160APHD
- ITAA 1936 160APHE
- ITAA 1936 160APHN
- ITAA 1936 160APHN(2)
- ITAA 1936 160APHN(3)
- ITAA 1936 160APHN(4)
- ITAA 1936 160APHO
- ITAA 1936 160APHO(1)(b)
- ITAA 1936 160APHO(2)
- ITAA 1936 160APHO(2)(a)
- ITAA 1936 160APHO(3)
- ITAA 1936 177E
- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1936 177EA(3)(a)
- ITAA 1936 177EA(3)(b)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(5)
- ITAA 1936 177EA(5)(a)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(17)
- ITAA 1936 177F
- ITAA 1936 177F(1)
- ITAA 1997
- ITAA 1997 Pt 3-1
- ITAA 1997 104-10
- ITAA 1997 104-10(1)
- ITAA 1997 104-10(2)
- ITAA 1997 104-10(3)
- ITAA 1997 104-10(3)(b)
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- ITAA 1997 Div 115
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- ITAA 1997 116-20(1)
- ITAA 1997 Pt 3-3
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- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)
- ITAA 1997 204-30(3)(a)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 204-30(6)(a)
- ITAA 1997 204-30(6)(e)
- ITAA 1997 Div 230
- TAA 1953
- Copyright Act 1968

ATO references

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