CR 2012/100 - Income tax: conversion by Poultry Farmers of Western Australia Co-operative Ltd to a company registered under the Corporations Act 2001

Class Ruling

Income tax: conversion by Poultry Farmers of Western Australia Co-operative Ltd to a company registered under the *Corporations Act 2001*

Contents Para

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:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45 of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the 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.

Class of entities

3. The class of entities to which this Ruling applies are members of Poultry Farmers of Western Australia Co-operative Ltd (PFC) who:

(a) receive shares in the proposed Nufeeds Ltd under the scheme;

(b) are residents of Australia within the meaning of that expression in subsection 6(1) of the ITAA 1936; and

(c) are not subject to the taxation of financial arrangements provisions in Division 230 of the ITAA 1997.

(Note - Division 230 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 20 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.

Date of effect

8. This Ruling applies from 3 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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 from Clayton Utz on behalf of Poultry Farmers of Western Australia Co-operative Ltd dated 24 May 2012;
- Articles of Association (Articles) of Poultry Farmers of Western Australia Co-operative Ltd received 21 June 2012;
- the Memorandum of Association (MOA) of Poultry Farmers of Western Australia Co-operative Ltd received 21 June 2012;
- Nufeeds Limited draft Constitution received 21 June 2021;
- the Poultry Farmers of Western Australia Co-operative Ltd Conversion Proposal – Information Memorandum for Members, received 21 June 2021; and
- correspondence received from Clayton Utz between 24 May 2021 and 20 September 2012.

10. PFC is a co-operative registered under the *Companies (Co-operative) Act 1943* (WA) (CCA) since 26 July 1991. PFC was formed to supply to its members chicken feed and other related products.

11. In relation to PFC:

- there is only one class of share on issue being $1 ordinary shares;
- there are 1,002,587 shares on issue;
- there are 66 members;
- all Members are Australian residents;

- all of PFC's real property assets are located in Western Australia; and
- all Members hold their shares on capital account.

12. Each member under PFC's Memorandum of Association and Articles of Association has an entitlement to:

- vote (each member has only one vote regardless of the number of shares that member owns);
- receive dividends, the total amount being subject to certain restrictions; and
- if PFC is liquidated, receive a distribution of capital based on the paid up capital and the number of shares that a member owns, plus a proportion of any surplus funds in the hands of the liquidator based on the volume of business that each member has done with the co-operative in the preceding 5 year period.

13. Under the current Constitution PFC's Board has the power to buy back shares of inactive members, that is, members who have not had dealings with PFC within the 3 years immediately preceding the proposed buy-back. PFC is currently registered as the holder of 21,372 shares which it has bought back from inactive members. These shares are referred to as 'Treasury Shares'.

14. Currently PFC has:

- one shareholder, Sunrange Farms Pty Ltd which owns 57% of the issued shares in PFC; and
- one shareholder, AAA Egg Company Pty Ltd which owns 8.9% of the shares in PFC.

15. PFC wishes to convert (Conversion) from a company incorporated under the CCA into a company incorporated under the *Corporations Act 2001* (Corporations Act). The reasons for proposing a restructure as advised by the applicant include:

- the *Co-operative Act 2009* (WA) (New Co-operatives Act) requires that PFC transition from the CCA to the New Co-operatives Act if it wishes to remain a co-operative. PFC does not wish to remain a co-operative and wishes to undergo the Conversion instead of transitioning to the New Co-operatives Act;
- to maximise the distribution of dividends to Members. Currently PFC's Constitution restricts the amount of dividends that can be paid to the Members. After the Conversion, these restrictions will no longer apply and dividends will be based on:

  (i) number of shares held;

  (ii) profitability of PFC; and

  (iii) recommendations of the directors of PFC; and

- the proposed Constitution will not restrict the activities that PFC can undertake, creating a more dynamic and flexible operating structure.

16. As part of the proposed Conversion:

- the MOA and Articles will be replaced by a new constitution (proposed Nufeeds Ltd Constitution);
- each Member's share will be cancelled and replaced with an ordinary share;
- ordinary shares have an equal entitlement to dividends and capital distributions based on the number of shares held by the Member;
- ordinary shares have an entitlement to cast 1 vote per share held; and
- the winding up provisions as contained in the proposed Nufeeds Ltd Constitution provide for the same distribution entitlements as those contained in the current Articles of PFC.

17. PFC will not participate as a PFC shareholder in the cancellation and replacement of the PFC shares. The Treasury Shares will therefore be cancelled prior to the new ordinary shares being issued in accordance with the Conversion proposal.

18. Once the proposed Conversion takes place, PFC proposes to change its name to Nufeeds Ltd.

19. The applicant affirms that there will be no decrease in the market value of any PFC shares during the scheme period. The applicant has also stated that because of the Conversion, the value of all Members interests in Nufeeds Ltd will increase.

20. On 31 July 2012, Members of PFC unanimously approved the Conversion of PFC from a co-operative to a body incorporated under the Corporations Act, subject to an application being made to the Australian Securities and Investment Commission.

Ruling

Choosing Subdivision 124-I roll-over for conversion

21. Members of PFC can choose roll-over under section 124-520 of the ITAA 1997 for the ending of their shares and interests in PFC on the Conversion.

Value shifting provisions

22. For the members of PFC, the scheme involving the Conversion of PFC to Nufeeds Ltd is not one to which any of the consequences of Divisions 725 of the ITAA 1997 or Division 727 of the ITAA 1997 will apply.

Assessable dividend

23. The 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.

Anti-avoidance provisions

24. Section 45 of the ITAA 1936 will not apply to treat any amount as a dividend as a consequence of the Conversion.

25. Sections 45A and 45B of the ITAA 1936 will not apply to the issue of shares in Nufeeds Ltd. The Commissioner will not, therefore, make a determination that section 45C of the ITAA 1936 applies to deem the issue of shares to be an unfranked dividend.

Commissioner of Taxation
31 October 2012

Appendix 1 – Explanation

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.

Choosing Subdivision 124-I roll-over for conversion

26. Subdivision 124-I of the ITAA 1997 allows a member of a body that is incorporated under a law other than company law to choose roll-over for a CGT event that happens if the incorporated body converts to a company incorporated under the Corporations Act or a similar foreign law. The conditions for the roll-over are listed in subsection 124-520(1) of the ITAA 1997.

Conditions for roll-over – members

27. CGT event C2 in section 104-25 of the ITAA 1997 happens when a member's share in PFC ends on the conversion of PFC to a company incorporated under the Corporations Act. Members of PFC will be able to choose to obtain roll-over relief under section 124-520 of the ITAA 1997 as the conditions for choosing roll-over will be satisfied.

28. Paragraph 124-520(1)(a) of the ITAA 1997 requires that the member choosing roll-over is a member of a body that is incorporated under a law other than the Corporations Act or a similar foreign law or the *Corporations (Aboriginal and Torres Strait Islander) Act 2006.*

29. This requirement is satisfied as PFC is incorporated under the CCA.

30. Paragraph 124-520(1)(b) of the ITAA 1997 requires that the body is converted into a company incorporated under either the Corporations Act or a similar foreign law or the *Corporations (Aboriginal and Torres Strait Islander) Act 2006,* without creating a new legal entity.

31. This condition will be satisfied when PFC is registered as a company (as Nufeeds Ltd) under the Corporations Act. Under paragraph 601BM(1)(a) of the Corporations Act and section 176E of the CCA, the incorporation does not create a new legal entity.

32. Paragraph 124-520(1)(c) of the ITAA 1997 requires that there is no significant difference between:

(i) the ownership of the body and of rights relating to the body held by entities that owned 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 and of rights relating to the body held by entities that owned the body, just before the Conversion and the mix of the ownership of the company just after the Conversion.

33. Subparagraph 124-520(1)(c)(i) of the ITAA 1997 will be satisfied on the facts of this scheme. Just before the Conversion, the owners of PFC are the members who hold shares in PFC. The owners of Nufeeds Ltd just after the Conversion will be those members of PFC just before the Conversion who will be issued with shares in Nufeeds Ltd.

34. Subparagraph 124-520(1)(c)(ii) of the ITAA 1997 will be satisfied on the facts of this scheme. It is reasonable to conclude that there is no significant difference between the mix of ownership just before and just after the Conversion. The replacement company shares in Nufeeds Ltd will be issued to members of PFC in the same number as those held in PFC. The class of shares in Nufeeds Ltd is reflective of the type of membership interest in PFC.

35. The change in voting interests between PFC (one vote per member) and Nufeeds Ltd (one vote per share) will not cause a significant difference between the mix of ownership of PFC just before the Conversion and the mix of ownership of the company just after the Conversion for the purposes of subparagraph 124-520(1)(c)(ii) of the ITAA 1997.

36. The condition in subsection 124-520(2) of the ITAA 1997 requires that a company issues shares to members (and nothing else) in substitution for their interest in the body just before the Conversion.

37. This condition will be satisfied when Nufeeds Ltd issues shares to the members of PFC (and nothing else) in substitution for their interests in PFC held just before the Conversion. Each member of PFC will receive only shares in Nufeeds Ltd in substitution for their interests in PFC.

38. Subsection 124-520(2) of the ITAA 1997 also 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.

39. This requirement is satisfied as all members of PFC are residents of Australia.

Consequences if Subdivision 124-I rollover is chosen

40. The consequences of a choice being made to apply the roll-over in Subdivision 124-I of the ITAA 1997 are set out in Subdivision 124-A of the ITAA 1997:

- For a member that holds PFC shares, 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 a new Nufeed Ltd share will be worked out by apportioning the sum of the cost bases of the PFC shares that have ended over the number of new Nufeeds Ltd shares.

Value shifting consequences

41. There can only be consequences under Division 725 of the ITAA 1997 where there is a direct value shift. One of the requirements for there to be a direct value shift as defined in section 725-145 of the ITAA 1997 is that there is a decrease in the market value of one or more equity or loan interests in an entity, where the decrease is reasonably attributable to one or more things done under a scheme involving those interests. On the facts of the arrangement there will be no decrease in value of any Member's interests in PFC during the scheme period and therefore there will be no consequences under Division 725.

42. An indirect value shift as defined in subsection 727-150(3) of the ITAA 1997 involves an unequal exchange of economic benefits between two entities, called the losing entity and gaining entity. The consequences for an indirect value shift, which will only arise where certain conditions about control and other matters in section 727-100 of the ITAA 1997 are satisfied, are limited to making adjustments for equity or loan interests in the losing entity for which there is a decrease in market value that is attributable to the indirect value shift, and in some cases compensating adjustments for equity or loan interests in the gaining entity: Subdivisions 727-G and 727-H of the ITAA 1997. Based on a consideration of all of the facts including that no PFC share decreases in value during the scheme period, it can be concluded that there will be no indirect value shift under the arrangement for which there will be any consequences under Division 727 of the ITAA 1997.

Assessable dividend

43. 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.

44. The issue of Nufeeds Ltd shares to members upon Conversion will not involve a distribution of money or property of Nufeeds Ltd to the shareholders.

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

46. 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 Nufeeds Ltd will not constitute a dividend.

Anti-avoidance provisions

Section 45

47. Section 45 of the ITAA 1936 applies where a company streams the provision of bonus shares and the payment of minimally franked dividends to its shareholders in such a way that bonus shares are received by some shareholders and minimally franked dividends are received by other shareholders. As the described share issue arrangement does not contemplate the distribution of dividends, section 45 does not apply.

Section 45A

48. Sections 45A and 45B of the ITAA 1936 are anti-avoidance provisions which, if either applies, allow the Commissioner to make a determination under section 45C of the ITAA 1936 that all or part of a capital benefit is treated as an unfranked dividend.

49. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit than other shareholders from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

50. The 'provision of a capital benefit' is defined in subsection 45A(3) of the ITAA 1936 to include the provision to a shareholder of shares in Nufeeds Ltd.

51. Although a 'capital benefit', as defined in paragraph 45A(3)(a) of the ITAA 1936, will be provided to the PFC members, the circumstances of the Conversion and share issue arrangement indicate that there is no streaming of the provision of shares to some members and the payment of dividends to other members. As the second condition in subsection 45A(1) of the ITAA 1936, is not satisfied, section 45A of the ITAA 1936 will not apply to the issue of shares.

52. As section 45A of the ITAA 1936 will not apply to the issue of shares, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to deem the provision of shares to be an unfranked dividend.

Section 45B

53. Section 45B of the ITAA 1936 applies where certain capital benefits are provided to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is 'provided with a capital benefit' by a company (paragraph 45B(2)(a) of the ITAA 1936);
- under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, 'obtains a tax benefit' (paragraph 45B(2)(b) of the ITAA 1936); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to 'obtain a tax benefit' (paragraph 45B(2)(c) of the ITAA 1936).

54. In this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 will be met, it is apparent that there is no requisite purpose, in the Conversion, by way of capital distribution, of enabling the members to obtain a tax benefit.

Appendix 2 – Detailed contents list

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

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 6(1)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45B
- ITAA 1936 45C
- 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(2)
- ITAA 1997 Div 725
- ITAA 1997 725-145
- ITAA 1997 Div 727
- ITAA 1997 727-100
- ITAA 1997 727-150
- ITAA 1997 727-150(3)
- ITAA 1997 Subdiv 727-G
- ITAA 1997 Subdiv 727-H
- Corporations Act 2001
- Corporations Act 2001 601BM(1)(a)
- TAA 1953
- Co-operatives Act 2009 (WA)
- Co-operatives Act 2009 (WA) 176E

ATO references

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ATOlaw topic: Income Tax ~~ Assessable income ~~ dividend, interest and royalty income

Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 – end of a CGT asset

Income Tax ~~ Capital Gains Tax ~~ cost base and reduced cost base

Income Tax ~~ Capital Gains Tax ~~ roll-overs – other

Income Tax ~~ Capital Gains Tax ~~ value shifting