


CR 2014/35 - Income tax: demutualisation of Transport Friendly Society Ltd

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Class Ruling

Income tax: demutualisation of Transport Friendly Society Ltd

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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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provisions

2. The relevant provisions dealt with in this Ruling are:
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 316-55 of the ITAA 1997;
 - section 316-105 of the ITAA 1997;
 - section 316-160 of the ITAA 1997;
 - subsection 316-165(2) of the ITAA 1997;
 - section 316-170 of the ITAA 1997;
 - section 316-200 of the ITAA 1997;
 - subsection 316-205(2) of the ITAA 1997; and
 - section 316-255 of the ITAA 1997.

All legislative references are to the ITAA 1997 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies are:
- members of Transport Friendly Society Ltd (TFSL), ABN 75 052 046 625, who are absolutely entitled to receive demutualised shares on the implementation date of 30 June 2014;
 - the Trustee of the TFSL Unverified Members Trust, to the extent the TFSL demutualised shares are received and later transferred to eligible and verified members of TFSL;
 - the Trustee of the TFSL Overseas Members Trust, to the extent the TFSL demutualised shares are received, later sold and share sale proceeds transferred to the eligible and verified overseas members; and
 - are not subject to the Taxation of Financial Arrangement (TOFA) rules in Division 230 in relation to gains and losses on their TFSL demutualised shares.
- (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 this 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 8 to 22 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

7. This Ruling applies from 1 July 2013 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

8. 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 dated 28 January 2014;
- final draft TFSL disclosure document dated 20 January 2014 (the final published and registered version of the TFSL disclosure document dated 27 February 2014 has also been received, and no material changes have been advised from an income tax viewpoint);
- draft Trust Deed of TFSL Overseas Members Trust dated 22 January 2014;
- draft Trust Deed of TFSL Unverified Members Trust dated 22 January 2014; and
- draft constitution of TFSL dated 23 January 2014.

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

9. TFSL is a 'friendly society' as defined in section 995-1. TFSL does not have capital divided into shares held by its members.

10. TFSL is a body that is permitted, by a State law or a Territory law, to assume or use the expression 'friendly society'.

11. TFSL is a friendly society which has a wholly-owned subsidiary (Transport Health Pty Ltd, ABN 39 099 028 127) that is a private health insurer as defined in the *Private Health Insurance Act 2007*.

12. TFSL was a friendly society that inter alia operated as a 'private health insurer' as at 1 July 1999 – at the time of its regulatory migration as a 'transferring friendly society' from State to Commonwealth jurisdiction, under section 11 of Division 5 of Part 1 of Schedule 8 to the *Financial Sector Reform (Amendments and Transitional Provisions) Act (No 1) 1999*.

13. Prior to 1 July 1999, TFSL was registered or incorporated as a 'friendly society' under a law of a state, being the *Friendly Societies Act 1986* of the State of Victoria.

14. On 2 April 2014, members of TFSL voted on whether to demutualise under Part 5 of Schedule 4 to the *Corporations Act 2001*.

15. The demutualisation will involve changing the company type under section 163(3) of the *Corporations Act 2001*, from (effectively) a company limited by guarantee to a company limited by shares. After demutualisation, TFSL will be carried on for the object of securing a profit or pecuniary gain for its members.

16. The effective cut-off date to calculate entitlement to participate in an allocation of demutualised shares is 28 February 2014.

17. The Implementation Date of the demutualisation is expected to be 30 June 2014. On this date, demutualised shares will be issued by TFSL to absolutely entitled verified members.

18. The verification period is expected to begin on 2 April 2014 (the date of the extraordinary general meeting of members) and end on either 31 December 2015 or 30 June 2016.

19. An eligible member of TFSL, who becomes absolutely entitled to receive TFSL demutualisation shares upon being verified in accordance with their allocated entitlement, is a person who:

- (a) is a member of TFSL at the cut-off entitlement date being 28 February 2014; and
- (b) is established as a verified member – either upon the proposed demutualisation of TFSL, or during the verification period.

20. Absolute entitlement to receive TFSL demutualisation shares arises as follows:

- (a) An immediately-verified member (who is not an overseas member) who:
 - (i) receives an immediate allocation of shares, after implementation of the demutualisation arrangement; and
 - (ii) may receive a further allocation of shares, from the pool of any residual shares at the end of the verification period.
- (b) A subsequently-verified member (who is not an overseas member) who:

- (i) is verified and receives an allocation of shares during the verification period; and
 - (ii) may receive a further allocation of shares, from the pool of any residual shares at the end of the verification period.
- (c) An immediately-verified (or subsequently-verified) member who is an overseas member where:
 - (i) the trustee of the TFSL Overseas Members Trust receives the member's allocation of shares, which it holds and later sells on behalf of the member; and
 - (ii) distributes the appropriate amount of share sale proceeds (including any capital gain component) to the member.

21. Shares for unverified members who are not overseas members will initially be issued to the Trustee of the TFSL Unverified Members Trust pending subsequent verification.

22. Under the demutualisation:

- the members cease to be mutual members of TFSL;
- TFSL issues shares to each person specified in the list that must be prepared under section 163(3) of the *Corporations Act 2001*; and
- each person specified in the list is taken to have consented to being a shareholder of TFSL.

Ruling

Capital Gains Tax (CGT)

23. CGT event C2 happens when a membership interest in TFSL ends as a result of the demutualisation of TFSL (subsection 104-25(1)).

24. The time when CGT event C2 happens is the Implementation Date of 30 June 2014 (subsection 104-25(2)).

Division 316

25. Any capital gain or capital loss made by a member of TFSL when CGT event C2 happens upon demutualisation of the member's interests is disregarded (section 316-55).

26. The first element of the cost base and reduced cost base of the TFSL demutualisation shares allocated to verified members following demutualisation of TFSL is calculated using the formula in subsection 316-105(2).

27. The time of acquisition of each TFSL demutualisation share is when the share is issued (subsection 316-105(3)).

28. Where a TFSL demutualisation share, or an interest in a TFSL demutualisation share, forms part of a member's deceased estate, was not owned by the member just before death and passes to a beneficiary in the member's estate by transfer from the member's legal personal representative:

- (a) any capital gain or capital loss made by the legal personal representative is disregarded (subsection 316-200(2)); and
- (b) when the TFSL demutualisation share passes to the beneficiary:
 - (i) the cost base and reduced cost base of the share in the hands of the legal personal representative just before it passes to the beneficiary becomes the first element of the cost base and reduced cost base of the share in the hands of the beneficiary (subsection 316-200(3)); and
 - (ii) the beneficiary is taken to have acquired the share when the legal personal representative acquired it (subsection 316-200(4)).

29. Where a TFSL demutualisation share, or an interest in a TFSL demutualisation share, held by the TFSL Unverified Members Trust is transferred to an eligible and verified member who is or becomes entitled to the receipt of the share:

- (a) any capital gain or capital loss made from a CGT event that happens to the beneficiary's interest in the TFSL Unverified Members Trust is disregarded (section 316-160);
- (b) any capital gain or capital loss made by the trustee from the CGT event that happens is disregarded (subsection 316-170(2));
- (c) the cost base and reduced cost base of the share in the hands of the trustee just before the share passes to the beneficiary becomes the first element of the cost base and reduced cost base of the share in the hands of the beneficiary (subsection 316-170(3)); and
- (d) the beneficiary is taken to have acquired the share when the trustee acquired it (subsection 316-170(4)).

30. Where a TFSL demutualisation share, or an interest in a TFSL demutualisation share, held by the Trustee of the TFSL Unverified Members Trust is transferred to a member's deceased estate, was not owned by the member just before death and passes to a beneficiary in the member's estate by transfer from the member's legal personal representative:

- (a) any capital gain or capital loss made by the legal personal representative from the CGT events that happen is disregarded (subsections 316-200(2) and 316-205(2)); and
- (b) when the TFSL demutualisation share passes to the beneficiary:
 - (i) the cost base and reduced cost base of the share in the hands of the legal personal representative just before it passes to the beneficiary becomes the first element of the cost base and reduced cost base of the share in the hands of the beneficiary (subsection 316-200(3)); and
 - (ii) the beneficiary is taken to have acquired the share when the legal personal representative acquired it (subsection 316-200(4)).

31. Where the proceeds from the sale of a TFSL demutualisation share, held by the Trustee of the TFSL Overseas Members Trust is transferred to an eligible and verified member who is or becomes entitled to the receipt of the shares, the capital gain or capital loss made from the CGT event that happens is determined by using the formula in subsection 316-165(2).

32. An amount that would otherwise be included in the ordinary income or statutory income (other than a net capital gain) of an eligible and verified member in relation to the TFSL demutualisation shares or right to acquire one or more TFSL demutualisation shares is not assessable income and is not exempt income (section 316-255).

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 C2

33. CGT event C2 happens on the ending of an intangible asset such as a membership interest in a friendly society (subsection 102-25(1)). Where the ending is not under a contract, CGT event C2 happens at the time of the ending of the asset (subsection 102-25(2)).

34. Accordingly, CGT event C2 happens on the Implementation Date of 30 June 2014 when the member's interest in TFSL ends as a result of the demutualisation of TFSL.

Division 316

35. Division 316 sets out the special tax consequences following the demutualisation of a friendly society that provides health and/or life insurance. Section 316-5 sets out three conditions that must be satisfied for Division 316 to apply. Those conditions are that:

- the society is, or has a wholly-owned health/life insurance subsidiary that is:
 - a private health insurer as defined in the *Private Health Insurance Act 2007*; or
 - a company registered under section 21 of the *Life Insurance Act 1995*; and
- the society does not have capital divided into shares held by its members; and
- after the demutualisation the society is to be carried on for the object of securing a profit or pecuniary gain for its members.

36. Under the scheme to which this Ruling relates the conditions in section 316-5 are satisfied.

CGT Consequences

37. Section 316-55 provides that a verified member's capital gain or capital loss when CGT event C2 happens on the ending of the corresponding membership interest is disregarded.

38. The first element of the cost base and reduced cost base of each TFSL demutualisation share allocated to the verified member is the amount calculated using the formula in subsection 316-105(2). Under subsection 316-105(3) the time of acquisition each TFSL demutualisation share is when the share is issued.

Legal personal representatives and beneficiaries of member deceased estates

39. Section 316-200 specifies the CGT consequences of a demutualised asset, which forms part of a member's deceased estate, was not owned by the member immediately before death and is subsequently transferred to beneficiaries of the deceased estate by the personal legal representative.

40. Under subsection 316-200(2), any capital gain or capital loss made by the legal personal representative by way of a transfer of the TFSL demutualisation shares to a beneficiary from the member's deceased estate is disregarded.

41. Under subsection 316-200(3), the cost base and reduced cost base of the TFSL demutualisation share in the hands of the legal personal representative just before the share passes to the beneficiary becomes the first element of the cost base and reduced cost base of the share in the hands of the beneficiary of the member's deceased estate.

42. Under subsection 316-200(4), the beneficiary is taken to have acquired the TFSL demutualisation shares at the time the shares were acquired by the legal personal representative of the deceased estate.

43. Section 316-205 specifies the CGT consequences for a personal legal representative of their interest in a lost policy holders trust. Under subsection 316-205(2), any capital gain or capital loss made from the CGT event that happens to the legal personal representative's interest in the TFSL Unverified Members Trust is disregarded when the TFSL demutualisation shares are issued to the deceased estate by the Trustee of the TFSL Unverified Members Trust provided the member did not own the shares on the day before they died and the shares are passed to a beneficiary of the member's estate.

Consequence for lost policy holders trusts and subsequently verified members

44. The TFSL Unverified Members Trust and the TFSL Overseas Members Trust are both lost policy holders trusts as described in section 316-155.

45. Under subsection 316-170(2), where a TFSL demutualisation share or an interest in a TFSL demutualisation share is held by the Trustee of the TFSL Unverified Members Trust and is subsequently transferred to an eligible and verified member, any capital gain or capital loss made by the trustee is disregarded.

46. Under subsection 316-160, where a TFSL demutualisation share or an interest in a TFSL demutualisation share is held by the Trustee of the TFSL Unverified Members Trust and is subsequently transferred to an eligible and verified member, any capital gain or capital loss made from the CGT event that happens to the beneficiary's interest in the TFSL Unverified Members Trust as a result of the transfer is disregarded.

47. The cost base and reduced cost base of the TFSL demutualisation share in the hands of the trustee just before the share passes to the beneficiary becomes the first element of the cost base and reduced cost base of the share in the hands of the beneficiary of the TFSL Unverified Members Trust (subsection 316-170(3)). The beneficiary of the Unverified Members Trust is taken to have acquired the shares when the Trustee of the TFSL Unverified Members Trust acquired them (subsection 316-170(4)).

48. Where TFSL demutualisation shares are sold by the Trustee of the TFSL Overseas Members Trust and the proceeds are distributed as money to an eligible and verified member, any capital gain or capital loss made from the CGT event that happens on the sale of the shares by the Trustee of the TFSL Overseas Members Trust is determined by using the formula in subsection 316-165(2).

Ordinary or Statutory Income

49. Section 316-255 outlines the general tax consequence of issuing demutualised assets. Subsection 316-255(2) applies where an entity:

- (a) is or has been a member of TFSL; or
- (b) is or has been insured through TFSL or through a health/life insurance subsidiary of TFSL; or
- (c) is issued with demutualised assets, or receives payment, because of the death of a person that:
 - had been a member of TFSL; or
 - had been insured through TFSL or through a health/life insurance subsidiary of TFSL; or
- (d) is a beneficiary of a lost policy holders trust (the TFSL Overseas Members Trust or the TFSL Unverified Members Trust).

50. Subsection 316-255(1) provides that an amount of ordinary income or statutory income (other than a net capital gain) of an entity described in subsection 316-255(2) is not assessable and is not exempt income if:

- (a) the amount would otherwise be included in the ordinary income or statutory income of an entity only because the demutualisation asset (TFSL demutualisation shares) was issued to the entity or because a TFSL demutualisation share or right to acquire one of more TFSL demutualisation shares was transferred to the entity by the trustee of the TFSL Unverified Members Trust or the TFSL Overseas Members Trust; or
- (b) the amount is a payment made to the entity under the demutualisation or payment made from the TFSL Unverified Members Trust or the TFSL Overseas Members Trust in connection with:
 - (i) the variation or abrogation of rights attaching to or consisting of an interest affected by demutualisation; or
 - (ii) the conversion, cancellation, extinguishment or redemption of an interest affected by demutualisation.

Appendix 2 – Detailed contents list

51. 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:

- Capital Gains Tax
- CGT demutualisation
- CGT events
- CGT events C1-C3 - end of a CGT asset
- friendly societies
- income
- non-assessable non-exempt income
- ITAA 1997 316-165(2)
- ITAA 1997 316-170(2)
- ITAA 1997 316-170(3)
- ITAA 1997 316-170(4)
- ITAA 1997 316-200
- ITAA 1997 316-200(2)
- ITAA 1997 316-200(3)
- ITAA 1997 316-200(4)
- ITAA 1997 316-205
- ITAA 1997 316-205(2)
- ITAA 1997 316-255
- ITAA 1997 316-255(1)
- ITAA 1997 316-255(2)
- ITAA 1997 995-1
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001 Sch 4 Pt 5

Legislative references:

- ITAA 1997 104-25(1)
- ITAA 1997 104-25(2)
- ITAA 1997 316-5
- ITAA 1997 316-55
- ITAA 1997 316-105(1)
- ITAA 1997 316-105(2)
- ITAA 1997 316-105(3)
- ITAA 1997 316-155
- ITAA 1997 316-160
- Corporations Act 2001 163(3)
- Financial Sector Reform (Amendments and Transitional Provisions) Act (No 1) 1999
- Friendly Societies Act 1986
- Private Health Insurance Act 2007

ATO references

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