


CR 2018/21 - Income tax: Pepper Group Limited Scheme of Arrangement and Payment of Special Dividend

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Class Ruling

Income tax: Pepper Group Limited Scheme of Arrangement and Payment of Special Dividend

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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.

Summary – 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 provisions

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) of the ITAA 1936
- section 128B of the ITAA 1936
- section 128D of the ITAA 1936
- Division 1A of former Part IIIA of the ITAA 1936
- former section 160APHE of the ITAA 1936
- former section 160APHN of the ITAA 1936
- former section 160APHO of the ITAA 1936
- section 177EA of the ITAA 1936

- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 67-25 of the ITAA 1997
- section 104-10 of the ITAA 1997
- Division 115 of the ITAA 1997
- subsection 116-20(1) of the ITAA 1997
- Subdivision 124-M of the ITAA 1997
- section 202-40 of the ITAA 1997
- section 202-75 of the ITAA 1997
- section 204-20 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 207-20 of the ITAA 1997
- subsection 207-35(1) of the ITAA 1997
- section 207-45 of the ITAA 1997
- section 207-145 of the ITAA 1997.

All subsequent legislative references in this Ruling are to provisions of the ITAA 1997 unless specified otherwise.

Class of entities

3. The class of entities to which this Ruling applies are the shareholders of Pepper Group Limited (**Pepper**) who:

- held their Pepper shares on capital account, that is the shares were neither held as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1))
- transferred their Pepper shares to Red Hot Australia Bidco Pty Limited (**Bidco**) pursuant to the Scheme (described below) and in exchange either received replacement shares in Red Hot Australia Holdco Pty Limited (**Holdco**) or received the Cash Payments
- were not exempt from income tax
- were not subject to the investment manager regime under Subdivision 842-I, and
- were not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Pepper shares.

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

4. In this Ruling, an entity belonging to this class of entities is referred to as a Scheme Shareholder.

5. This Ruling does not apply to the Pepper shareholders that validly elected under the Scheme to retain their Pepper Shares.

Qualifications

6. The Commissioner makes this Ruling based on the precise scheme 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 10 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.

Date of effect

9. This Ruling applies from 1 July 2017 to 30 June 2018. The Ruling continues to apply after 30 June 2018 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

10. The following description of the scheme is based on information provided by the applicant.

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

Capitalised terms referred to in this ruling are as defined in the ruling application and supporting documents.

Summary

11. On 4 December 2017 (**Implementation Date**) a scheme of arrangement (**Scheme**) between Pepper and its shareholders was implemented. The Scheme was approved by the shareholders of Pepper and by the Federal Court under section 411 of the *Corporations Act 2001*.

12. The Scheme resulted in Red Hot Australia Bidco Pty Limited (**Bidco**) acquiring 94.38% of the shares in Pepper from the Scheme Shareholders who held their Pepper shares at the record date for the Scheme being 27 November 2017 (**Scheme Record Date**). The 5.62% of the Pepper shares not acquired by Bidco were retained by those eligible Pepper shareholders that validly elected under the Scheme to retain their Pepper shares (**Retention Option**).

13. For the Scheme Shareholders who transferred their Pepper shares to Bidco under the Scheme, the Scheme resulted in the following consideration being received in exchange for their Pepper shares (**Scheme Consideration**):

- for those eligible Scheme Shareholders that validly elected the Scrip Option, one new share (**Holdco Shares**) in Red Hot Australia Holdco Pty Limited (**Holdco**) for each Pepper share they held at the Scheme Record Date (27 November 2017). These Scheme Shareholders held in aggregate approximately 40.88% of Pepper shares. These Scheme Shareholders were not entitled to receive the 10c special dividend from Pepper mentioned in paragraph 14 of this Ruling
- for those Scheme Shareholders that did not validly elect the Scrip Option or the Retention Option, A\$3.60 cash (**Cash Consideration**) for each Pepper share held at the Scheme Record Date (27 November 2017). These Scheme Shareholders held in aggregate approximately 53.50% of Pepper shares. These Scheme Shareholders received the 10c special dividend from Pepper mentioned in paragraph 14 of this Ruling (together, **Cash Payments** aggregating to A\$3.70 per share).

14. Pursuant to an amendment to Pepper's Constitution approved by Pepper shareholders, those Scheme Shareholders that did not validly elect the Scrip Option or Retention Option (that is, only those that received the Cash Consideration under the Scheme) received from Pepper a fully franked special dividend of 10c per Pepper share (**Special Dividend**) held at the record date for the Special Dividend being 23 November 2017 (**Special Dividend Record Date**).

Background***Pepper***

15. Pepper was an Australian public company that was listed on the Australian Securities Exchange (ASX) from 31 July 2015 until 5 December 2017.

16. Prior to Implementation of the Scheme, Pepper had over 184m issued shares and over 750 registered shareholders including nominees and trustees.

17. Since being listed Pepper has paid two final dividends of 3.0c and 5.4c per share fully franked on 20 April 2016 and 12 April 2017 respectively and an interim dividend of 3.0c per share fully franked on 5 October 2016. Consistent with this pattern, on 25 August 2017 the board of directors of Pepper determined that a fully franked interim dividend of 3.0c per share would be paid in respect of Pepper's half year period ended 30 June 2017. The record date for the interim dividend was 13 September 2017 and the payment date was 5 October 2017 (**Interim Dividend**).

Bidco and Holdco

18. Bidco and Holdco are Australian proprietary companies incorporated on 7 July 2017 as special purpose entities in connection with the Scheme. Bidco is directly wholly owned by Holdco.

19. Bidco and Holdco were incorporated by and, prior to Implementation of the Scheme, were indirectly wholly owned by certain funds, clients or accounts managed or advised by KKR Credit Advisors (US) LLC (**KKR Credit**). Holdco is not a 100% subsidiary, (as defined in section 975-505) directly or indirectly, of another company and there are no current arrangements by which the direct shareholdings in Holdco will be modified, transferred or terminated following the Implementation Date.

20. Under the Scheme, Bidco provided the Scheme Consideration that consisted of the Cash Consideration and procured that Holdco issue Holdco Shares to the Scheme Shareholders that elected the Scrip Option.

KKR Credit

21. KKR Credit is an affiliate of Kohlberg Kravis Roberts & Co. L.P., a global investment firm that manages multiple asset classes, including private equity, energy, infrastructure, real estate, credit and through its partners, hedge funds.

The Scheme

22. On 10 August 2017, Pepper announced that it had entered into a Scheme Implementation Deed (**SID**) with Bidco under which it was proposed that Bidco would acquire at least 90.1% of the Pepper shares from Pepper shareholders by way of a scheme of arrangement (**Scheme**).

23. Bidco made a A\$3.60 per share cash offer (**Cash Consideration**), with an equity alternative of shares in Bidco's immediate parent, Holdco (**Scrip Option**) subject to a certain cap, and an option to retain Pepper shares and subsequently transfer outside the Scheme on equivalent commercial terms available to certain Pepper shareholders (**Retention Option**) subject to a cap of 9.9% of Pepper shares.

24. On 25 September 2017, Pepper announced that it had received an improved proposal from Bidco under which those Pepper shareholders receiving the Cash Consideration under the Scheme would now receive value of A\$3.70 per share comprising (a) A\$3.60 per share under the Scheme; plus (b) a special dividend of up to 10c per share fully franked.

25. The Scheme (as amended) was subject to various conditions precedent including that:

- Pepper shareholders approve an amendment to Pepper's Constitution by the requisite majority at the General Meeting (held on 15 November 2017) in order to permit the payment of the Special Dividend
- that the Special Dividend be declared or determined by the Pepper Board
- Pepper shareholders approve the Scheme by the requisite majority at the Scheme Meeting (held on 15 November 2017), and
- approval of the Scheme by the Federal Court.

26. All relevant conditions precedent were satisfied and the Scheme was implemented on 4 December 2017. The Special Dividend was also paid on 4 December 2017. Shares in Pepper were delisted from the ASX on 5 December 2017.

Ruling**Assessability of the Interim Dividend and Special Dividend**

27. The Interim Dividend and the Special Dividend each satisfy the meaning of 'dividend' as defined in subsection 6(1) of the ITAA 1936.

28. Scheme Shareholders who received the Interim Dividend and/or the Special Dividend and are residents of Australia as defined in subsection 6(1) of the ITAA 1936 are required to include the dividend or dividends (as applicable) as assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

29. Scheme Shareholders who received the Interim Dividend and/or the Special Dividend and are non-residents (other than those carrying on business in Australia at or through a permanent establishment in Australia to which the dividend was attributable) are not required to include either dividend as assessable income under subparagraph 44(1)(b)(i) of the ITAA 1936. This is because both dividends will not be liable for Australian withholding tax (paragraph 128B(3)(ga) of the ITAA 1936) and, as a result, both dividends will be treated as non-assessable, non-exempt income in the hands of such Scheme Shareholders (section 128D of the ITAA 1936).

30. A non-resident Scheme Shareholder who received the Interim Dividend and/or the Special Dividend and is carrying on business in Australia at or through a permanent establishment in Australia, where the relevant dividend is, or dividends are, attributable to the permanent establishment, is required to include the dividend or dividends (as applicable) as assessable income under both subparagraph 44(1)(b)(i) and subparagraph 44(1)(c)(i) of the ITAA 1936 and is not liable to Australian withholding tax in respect of the dividend (subsection 128B(3E) of the ITAA 1936).

Gross up and tax offset

31. The Interim Dividend and the Special Dividend were both frankable distributions under section 202-40.

32. A Scheme Shareholder who received the Interim Dividend and/or the Special Dividend directly and satisfies the residency requirements in section 207-75:

- must include the amount of the franking credit attached to the dividend or dividends (as applicable) in their assessable income, and
- will be entitled to a tax offset equal to the franking credit attached to the dividend or dividends (as applicable),

under section 207-20, subject to being a 'qualified person' (see paragraphs 35 to 40 of this Ruling) in relation to the dividend or dividends (as applicable).

33. A Scheme Shareholder (not being a corporate tax entity), who received the Interim Dividend and/or the Special Dividend as a trustee of a trust (not being a complying superannuation entity) or as a partnership, is required to include an amount equal to the franking credit attached to the dividend in its assessable income under subsection 207-35(1), subject to the trustee or the partnership being a 'qualified person'.

34. The relevant members of a partnership or trust to whom a distribution flows indirectly through the partnership or trust, are entitled to a tax offset under section 207-45, equal to their share of the franking credit attached to the distribution included in the assessable income of the partnership or trust under subsection 207-35(1).

Qualified persons – Interim Dividend

35. No 'related payment' occurred in respect of the Interim Dividend for the purposes of former section 160APHN of the ITAA 1936.

36. Accordingly, to be a qualified person in relation to the Interim Dividend, each Scheme Shareholder will need to hold each of their Pepper shares 'at risk' for a continuous period of at least 45 days in the 'primary qualification period'. A Scheme Shareholder must exclude any days on which they have materially diminished risks of loss or opportunities for gain in respect of their Pepper share, but this is not taken to break the continuity of the test period.

37. A Scheme Shareholder will be a qualified person in relation to the Interim Dividend if, in the period from the day after the taxpayer acquired the shares to 29 October 2017 (inclusive), they continued to hold their Pepper shares and did not have materially diminished risks of loss or opportunities for gain in respect of their Pepper shares for a continuous period of at least 45 days (not counting the day on which the shares were acquired or the day of disposal of the share). This will depend on each Scheme Shareholder's own circumstances and is outside the scope of this Ruling.

Qualified persons – Special Dividend

38. A 'related payment' for the purposes of former section 160APHN of the ITAA 1936 occurred in respect of the Special Dividend.

39. Accordingly, to be a qualified person in relation to the Special Dividend, each Scheme Shareholder will need to hold each of their Pepper shares 'at risk' for a continuous period of at least 45 days in the 'secondary qualification period'. A Scheme Shareholder must exclude any days on which they have materially diminished risks of loss or opportunities for gain in respect of their Pepper share, but this is not taken to break the continuity of the test period.

40. A Scheme Shareholder is considered to no longer hold any of their Pepper shares 'at risk' for the purposes of former Division 1A of Part IIIAA of the ITAA 1936 as from the Scheme Record Date (27 November 2017). A Scheme Shareholder will be a qualified person in relation to the Special Dividend if, in the period from 10 October 2017 to 26 November 2017 (inclusive), they continued to hold their Pepper share and did not have materially diminished risks of loss or opportunities for gain in respect of their Pepper share for a continuous period of at least 45 days (not counting the day on which the share was acquired or the day of disposal of the share). This will depend on each Scheme Shareholder's own circumstances and is outside the scope of this Ruling.

Refundable tax offset

41. The franking credit tax offset that a Scheme Shareholder is entitled to under Division 207 is subject to the refundable tax offset rules in Division 67, provided the Scheme Shareholder is not excluded by the operation of section 67-25.

Imputation benefits anti-avoidance provisions

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

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

Capital Gains Tax (CGT) consequences

CGT event A1

44. CGT event A1 happened when a Scheme Shareholder transferred each of their Pepper shares to Bidco pursuant to the Scheme (section 104-10).

45. The time CGT event A1 happened was when the Pepper shares were transferred to Bidco on the Scheme Implementation Date of 4 December 2017 (paragraph 104-10(3)(b)).

46. A Scheme Shareholder will make a capital gain from CGT event A1 happening if the capital proceeds from the disposal of the Pepper share exceeds the cost base of that share. A Scheme Shareholder will make a capital loss if the capital proceeds are less than the reduced cost base of the Pepper share (subsection 104-10(4)). The cost base and reduced cost base of a Pepper share depends on each Scheme Shareholder's own circumstances.

Capital proceeds

47. For Scheme Shareholders that received replacement Holdco Shares, the capital proceeds from CGT event A1 happening is the market value (worked out at the time of CGT event A1) of the replacement Holdco Shares received (paragraph 116-20(1)(b)).

48. For Scheme Shareholders that received the Cash Payments, the capital proceeds from CGT event A1 are the Cash Payments of \$3.70 per share received (paragraph 116-20(1)(a)). In the circumstances of this case, the capital proceeds for CGT purposes includes the Special Dividend.

CGT Anti-overlap provision

49. For Scheme Shareholders that received the Cash Payments, a capital gain made from CGT event A1 happening to their Pepper shares is reduced by the amount of the Special Dividend that is included in their assessable income under section 44 of the ITAA 1936 (section 118-20). This has the effect of reducing (but not below zero) the capital gain by the amount that is assessable under another provision.

50. A capital gain is not reduced by the amount of the franking credit (attached to the Special Dividend) that is included in their assessable income under section 207-20 (paragraph 118-20(1B)(b)).

Availability of scrip for scrip roll-over if a capital gain is made

51. Subject to the qualifications in paragraph 52 and 53 of this Ruling, a Scheme Shareholder that received replacement Holdco Shares and made a capital gain from the disposal of their Pepper shares may choose scrip for scrip roll-over (section 124-780).

52. Scrip for scrip roll-over cannot be chosen by a Scheme Shareholder that is a non-resident unless the replacement Holdco Shares are 'taxable Australian property' just after they were acquired (subsection 124-795(1)).

53. Scrip for scrip roll-over cannot be chosen if any capital gain the Scheme Shareholder might subsequently make from the replacement Holdco Shares would be disregarded, except because of a roll-over (subsection 124-795(2)).

54. If scrip for scrip roll-over is chosen, the capital gain from the disposal of their Pepper shares is disregarded (subsection 124-785(1)).

Discount capital gain

55. A Scheme Shareholder that makes a capital gain from the disposal of their Pepper shares in circumstances where roll-over is

not chosen, or cannot be chosen, will be eligible to treat the capital gain as a 'discount capital gain' provided that:

- the Scheme Shareholder is an individual, complying superannuation entity or, subject to the rules in Subdivision 115-C, a trust (section 115-10)
- the capital gain has been worked out using a cost base calculated without reference to indexation (subsection 115-20(1)), and
- the Pepper share was acquired at least 12 months prior to the CGT event A1 happening on 4 December 2017 (subsection 115-25(1)).

Cost base of replacement Holdco Shares

56. The cost base and reduced cost base of a replacement Holdco Share acquired by a Scheme Shareholder in exchange for their Pepper share, is affected by whether the Scheme Shareholder chooses scrip for scrip roll-over.

Where scrip for scrip roll-over is not chosen

57. Where scrip for scrip roll-over is not chosen, the first element of the cost base and reduced cost base of each replacement Holdco Share is equal to the market value of each Pepper share given in exchange for the acquisition of a replacement Holdco Share (subsections 110-25(2) and 110-55(2)). The market value is worked out at the time of the acquisition (subsection 110-25(2)).

Where scrip for scrip roll-over is chosen

58. Where scrip for scrip roll-over is chosen, the first element of the cost base and reduced cost base of a replacement Holdco Share is worked out by reasonably attributing to it the cost base of the Pepper share for which it was exchanged and for which the roll-over was obtained (subsections 124-785(2) and 124-785(4)). In this case, due to the one-for-one exchange ratio, the existing cost base of the Pepper share becomes the cost base of the replacement Holdco Share.

Acquisition date of replacement Holdco Shares

59. The acquisition date of the replacement Holdco Shares will be the date when the Holdco Shares are issued (Item 2 of the table in section 109-10).

60. However, for the purpose of determining whether a capital gain made from any later disposal of a replacement Holdco Share is a discount capital gain, Scheme Shareholders who choose scrip for scrip roll-over are taken to have acquired the replacement Holdco Share when they acquired the corresponding Pepper share involved in the roll-over (Item 2 of the table in subsection 115-30(1)).

Commissioner of Taxation

23 May 2018

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.*

The Interim Dividend and Special Dividend

61. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 to include any distribution made by a company to any of its shareholders, whether in money or other property.

62. The payment of the Interim Dividend and the Special Dividend was in each case a distribution in money made by Pepper to its shareholders.

63. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 excludes from the definition of 'dividend' any:

...

- (d) moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company; or

...

64. The Interim Dividend and the Special Dividend were each debited against Pepper's retained earnings. Pepper has not and will not debit the Interim Dividend or the Special Dividend against its share capital account. Therefore, the exclusion in paragraph (d) will not apply and the Interim Dividend and the Special Dividend will each constitute a 'dividend' for the purposes of subsection 6(1) of the ITAA 1936.

Assessability of the Interim Dividend and Special Dividend

Residents

65. Paragraph 44(1)(a) of the ITAA 1936 includes in the assessable income of an Australian resident shareholder in a company:

...dividends (other than non-share dividends) that are paid to the shareholder by the company out of profits derived by it from any source.

66. As the Interim Dividend and the Special Dividend were each paid to Scheme Shareholders out of profits derived by Pepper, Scheme Shareholders who are residents of Australia are required to include the dividend or dividends (as applicable) in their assessable income under paragraph 44(1)(a) of the ITAA 1936.

Non-residents (not carrying on business at or through a permanent establishment)

67. Subparagraph 44(1)(b)(i) of the ITAA 1936 includes in the assessable income of a non-resident shareholder in a company:

...dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia.

68. Subsection 128B(1) of the ITAA 1936 imposes Australian withholding tax on income that:

- (a) is derived, on or after 1 January 1968, by a non-resident; and
- (b) consists of a dividend paid by a company that is a resident.

69. However, subparagraph 128B(3)(ga)(i) of the ITAA 1936 excludes from subsection 128B(1) of the ITAA 1936 income derived by a non-resident that consists of the franked part of a dividend. As the Interim Dividend and the Special Dividend were both fully franked, neither will be subject to Australian withholding tax when derived by non-resident Scheme Shareholders.

70. In addition section 128D of the ITAA 1936 states that:

Income other than income to which section 128B of the ITAA 1936 applies by virtue of subsection (2A), (2C) or 9(C) of that section upon which withholding tax is payable, or upon which withholding tax would, but for paragraph 128B(3)(ga), (jb) or (m), section 128F, section 128FA or section 128GB, be payable, is not assessable income and is not exempt income of a person.

71. As the payment of the Interim Dividend and the Special Dividend each constituted income that was subject to withholding tax but for paragraph 128B(3)(ga) of the ITAA 1936, neither dividend will be assessable income or exempt income of non-resident Scheme Shareholders pursuant to section 128D of the ITAA 1936.

72. Accordingly, Scheme Shareholders who received the fully franked Interim Dividend and/or the Special Dividend and are non-residents (other than those carrying on business in Australia at or through a permanent establishment in Australia to which the dividend is attributable) are not required to include the dividend or dividends (as applicable) as assessable income under subparagraph 44(1)(b)(i) of the ITAA 1936 (section 128D of the ITAA 1936) and will not be liable for Australian withholding tax (paragraph 128B(3)(ga) of the ITAA 1936).

Non-residents (carrying on business at or through a permanent establishment)

73. A non-resident's liability to withholding tax on dividend income received in subsection 128B(1) of the ITAA 1936 is subject to subsection 128B(3E). Subsection 128B(3E) states that section 128B does not apply to dividend income that:

- (a) is paid to a person who is a non-resident carrying on business in Australia at or through a permanent establishment of the person in Australia; and
- (b) is attributable to the permanent establishment; and
- (c) is not paid to the person in the person's capacity as trustee.

74. Subparagraph 44(1)(b)(i) of the ITAA 1936 includes dividends in the assessable income of a non-resident shareholder of a company:

... to the extent to which they are paid out of profits derived by it from sources in Australia.

75. Subparagraph 44(1)(c)(i) of the ITAA 1936 includes dividends in the assessable income of a non-resident shareholder of a resident company, where the non-resident shareholder is carrying on business in Australia at or through a permanent establishment of the shareholder in Australia and those dividends:

... are attributable to the permanent establishment, to the extent to which they are paid out of profits derived by the company from sources outside Australia.

76. Accordingly, any non-resident Scheme Shareholders carrying on a business in Australia at or through a permanent establishment who received the Interim Dividend and/or the Special Dividend (otherwise than in their capacity as trustee) are required to include the dividend or dividends (as applicable) in their assessable income, to the extent to which the dividend or dividends were attributable to the permanent establishment, pursuant to subparagraph 44(1)(b)(i) and subparagraph 44(1)(c)(i) of the ITAA 1936 and will not be liable for Australian withholding tax in relation to the dividend or dividends (as applicable).

Gross up and tax offset

77. Section 207-20 provides:

- (1) If an entity makes a *franked distribution to another entity, the assessable income of the receiving entity, for the income year in which the distribution is made, includes the amount of the *franking credit on the distribution. This is in addition to any other amount included in the receiving entity's assessable income in relation to the distribution under any other provision of this Act.
- (2) The receiving entity is entitled to a *tax offset for the income year in which the distribution is made. The tax offset is equal to the *franking credit on the distribution.

78. Therefore, subject to satisfying the 'qualified person' rule, where the fully franked Interim Dividend and/or the Special Dividend is received directly by a Scheme Shareholder that is not a partnership or acting in the capacity of trustee, the Scheme Shareholder will:

- include the amount of the franking credit attached to the dividend or dividends (as applicable) in their assessable income, and
- be entitled to a tax offset equal to the amount of the franking credits so included.

79. Where the fully franked Interim Dividend and/or the Special Dividend is received by a Scheme Shareholder (not being an entity taxed as a corporate tax entity) that is a trustee of a trust (not being a complying superannuation fund) or a partnership, subsection 207-35(1) applies, subject to the trustee or partnership being a 'qualified person'. Subsection 207-35(1) provides:

If:

- (a) a *franked distribution is made in an income year to an entity that is a partnership or the trustee of a trust; and
- (b) the entity is not a *corporate tax entity when the distribution is made; and
- (c) if the entity is the trustee of a trust – the trust is not a *complying superannuation entity when the distribution is made;

the assessable income of the partnership or trust for that income year includes the amount of the *franking credit on the distribution.

80. Therefore, subject to satisfying the 'qualified person' rule, a Scheme Shareholder that is a trust or a partnership will be required to include the amount of the franking credit attached to the dividend or dividends in their assessable income under subsection 207-35(1).

Qualified persons, related payment and holding period rule

Qualified person

81. Pursuant to subsection 207-145(1), an entity must be a 'qualified person' in relation to a dividend in order to be entitled to a tax offset in respect of the franking credit on a dividend.

82. Former section 160APHU of the ITAA 1936 provides that a partner in a partnership or the beneficiary of a trust cannot be a qualified person in relation to a dividend unless the partnership or the trustee of the trust is also a qualified person in relation to the dividend.

83. Former Division 1A of Part IIIAA of the ITAA 1936 provides the statutory tests that must be satisfied for a taxpayer to be a 'qualified person' in relation to a franked distribution they have received and thus be entitled to a tax offset for the franking credit on the distribution. Former Division 1A has effect via the express terms of section 207-145.

84. The test of what constitutes a 'qualified person' is provided in former subsection 160APHO(1) 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, or 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 period in relation to the dividend.

85. Broadly, if Scheme Shareholders are not under an obligation to make a related payment in relation to a dividend or distribution, they will have to satisfy the holding period requirement within the primary qualification period. If Scheme Shareholders are under an obligation to make a related payment in relation to a dividend or distribution, they will have to satisfy the holding period requirement within the secondary qualification period.

Related payment rule

86. In order to determine what the relevant qualification period is, it is necessary to determine whether, under the present arrangement, a Scheme Shareholder has made, or is under an obligation to make, or is likely to make, a related payment in respect of any of the dividends they receive.

87. Former section 160APHN of the ITAA 1936 gives examples of, but does not limit, what constitutes the making of a related payment, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.

88. Former subsection 160APHN(2) of the ITAA 1936 states:

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.

89. 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 persons:

- (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.

90. 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:

- (d) is, or may reasonably be expected to be, equal to; or
- (e) approximates or may reasonably be expected to approximate; or
- (f) is calculated by reference to;

the amount of the dividend or distribution.

91. It is considered that a Scheme Shareholder that has received the Interim Dividend, has not made, nor is under an obligation to make, or is likely to make, a related payment in respect of any of the Interim Dividend.

92. However, in the circumstances of this Scheme, it is considered that the payment of the Special Dividend is an integral part of the Scheme from which Bidco benefits by way of the Scheme being approved by Pepper shareholders and thus causing the Pepper shares to be transferred to Bidco. Approval of the Scheme by Pepper Shareholders was made subject to various conditions precedent including that:

- Pepper shareholders approve an amendment to Pepper's Constitution by the requisite majority at the General Meeting (held on 15 November 2017) in order to permit the payment of the Special Dividend (to only the recipients of the Cash Consideration from Bidco), and
- that the Special Dividend be declared or determined by the Pepper Board.

93. The Special Dividend ensured relevant Scheme Shareholders would receive cash value of A\$3.70 while demanding only A\$3.60 from Bidco under the approved Scheme. Therefore, former subsection 160APHN(2) of the ITAA 1936 is satisfied and so a Scheme Shareholder is taken to have made a related payment in respect of the Special Dividend.

Holding period requirement

94. Former paragraph 160APHO(2)(a) of the ITAA 1936 provides that:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid satisfies this subsection in relation to a qualification period in relation to the shares or interest if, during the period:

- (a) where the taxpayer held the shares – the taxpayer held the shares for a continuous period (not counting the day on which the taxpayer acquired the shares or, if the taxpayer has disposed of the share, the day on which the disposal occurred) of not less than:
 - (i) if the shares are not preference shares – 45 days; or
 - (ii) if the shares are preference shares – 90 days.

95. As the Pepper shares are not preference shares, Scheme Shareholders are required to hold their shares for at least 45 days during the relevant qualification period.

Interim Dividend

96. As Scheme Shareholders are not taken, for the purposes of former Division 1A, to have made a related payment in respect of the Interim Dividend, the relevant qualification period is the 'primary qualification period' pursuant to former paragraph 160APHO(1)(a) of the ITAA 1936.

97. The former section 160APHD of the ITAA 1936 defines the 'primary qualification period' as follows:

In relation to a taxpayer in relation to shares or an interest in shares, means the period beginning on the day after the day on which the taxpayer acquired the shares or interest and ending:

- (a) if the shares are not preference shares – on the 45th day after the day on which the shares or interest became ex dividend ...

98. The concept of 'ex dividend' for this purpose is defined by former subsection 160APHE(1) of the ITAA 1936 as follows:

A share in respect of which a dividend is to be paid, or an interest (other than an interest as a beneficiary of a widely held trust) in such a share, becomes ex dividend on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

99. The eligibility for the Interim Dividend was determined on the record date of 13 September 2017. This was the last day on which acquisition by a person of a Pepper share entitled the person to receive the Interim Dividend as per former section 160APHE of the ITAA 1936. Accordingly, the ex-dividend date for the purposes of former subsection 160APHE(1) of the ITAA 1936 is 14 September 2017.

100. As per the definition in former section 160APHD of the ITAA 1936, the primary qualification period will begin the day after the day on which the taxpayer acquired the shares and end 45 days after the ex-dividend day. This means that the primary qualification period would, ordinarily, end on 29 October 2017 (45 days after 14 September 2017).

101. However, pursuant to former subsection 160APHO(3) of the ITAA 1936, any days on which an entity had materially diminished risks of loss or opportunities for gain in respect of their Pepper shares, or interest in Pepper shares, are excluded from counting towards the 45 day holding period requirement.

Subsection 160APHO(3) provides:

In calculating the number of days for which the taxpayer continuously held the shares or interest, any days on which the taxpayer has materially diminished risks of loss or opportunities for gain in respect of the shares or interest are to be excluded, but the exclusion of those days is not taken to break the continuity of the period for which the taxpayer held the shares or interest.

102. This will depend on each Scheme Shareholder's own circumstances and is therefore outside the scope of this Ruling.

Special Dividend

103. As Scheme Shareholders are taken, for the purposes of former Division 1A, to have made a related payment in respect of the Special Dividend, the relevant qualification period is the 'secondary qualification period' pursuant to former paragraph 160APHO(1)(b) of the ITAA 1936.

104. The former section 160APHD of the ITAA 1936 defines the 'secondary qualification period' 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 became ex dividend; or

...

105. The concept of 'ex dividend' for this purpose is defined by former subsection 160APHE(1) of the ITAA 1936 as follows:

A share in respect of which a dividend is to be paid, or an interest (other than an interest as a beneficiary of a widely held trust) in such a share, becomes ex dividend on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

106. The eligibility for the Special Dividend was determined on the record date of 23 November 2017. This was the last day on which acquisition by a person of a Pepper share entitled the person to receive the Special Dividend as per former section 160APHE of the ITAA 1936. Accordingly, the ex-dividend date for the purposes of former subsection 160APHE(1) of the ITAA 1936 is 24 November 2017.

107. As per the definition in former section 160APHD of the ITAA 1936, the secondary qualification period will begin 45 days before the ex-dividend date of 24 November 2017 and end 45 days after that day. This means that the secondary qualification period would, ordinarily, run from 10 October 2017 to 8 January 2018 (45 days before and 45 days after 24 November 2017).

108. However, pursuant to former subsection 160APHO(3) of the ITAA 1936, any days on which an entity had materially diminished risks of loss or opportunities for gain in respect of their Pepper shares, or interest in Pepper shares, are excluded from counting towards the 45 day holding period requirement. Subsection 160APHO(3) provides:

In calculating the number of days for which the taxpayer continuously held the shares or interest, any days on which the taxpayer has materially diminished risks of loss or opportunities for gain in respect of the shares or interest are to be excluded, but the

exclusion of those days is not taken to break the continuity of the period for which the taxpayer held the shares or interest.

109. It is considered that once a Scheme Shareholder is identified as a Scheme Shareholder on the Scheme Record Date (27 November 2017), that Scheme Shareholder would no longer be considered to hold their shares 'at risk' for the purposes of former Division 1A of former Part IIIAA of the ITAA 1936 as, at that time the Scheme Shareholder is committed to disposing of their Pepper shares and receiving the Scheme Consideration. This means that as and from 27 November 2017, Scheme Shareholders no longer held their Pepper shares 'at risk'. The days from 27 November 2017 and onwards are not counted toward the 45 day holding period.

110. Accordingly, a Scheme Shareholder who received the Special Dividend would need to have held their Pepper shares at risk for a continuous period of not less than 45 days during the period 10 October 2017 to 26 November 2017 in order to be a 'qualified person' for the purposes of former Division 1A of former Part IIIAA of the ITAA 1936. Pursuant to former paragraph 160APHO(2)(a) of the ITAA 1936, the dates of acquisition and disposal of a Pepper share are not included in the relevant 45 day period.

111. Scheme Shareholders would only have been able to satisfy the holding period requirement in relation to a Pepper share if they acquired that Pepper share on or before 12 October 2017 and held it 'at-risk' for at least 45 days during the period of 10 October to 26 November 2017 (not counting any day of disposal or acquisition). This will depend on each Scheme Shareholder's own circumstances and is therefore outside the scope of this Ruling.

Refundable tax offset

112. An entity entitled to a tax offset under subsection 207-20(2), in respect of the franking credit received, will also be subject to the refundable tax offset rules in Division 67, unless specifically excluded under section 67-25.

113. Pursuant to section 67-25, there are a range of taxpayers who are specifically excluded from the operation of the refundable tax offset rules. This range of excluded entities includes:

- non-complying superannuation funds or non-complying approved deposit funds (subsection 67-25(1A))
- a trustee of a trust who is liable to be assessed under section 98 or 99A of the ITAA 1936 (subsection 67-25(1B))
- corporate tax entities, unless the entity is an exempt institution that is eligible for a refund, or a life insurance company that has received distributions on membership interests which were not held by the company on behalf of its shareholders (subsections 67-25(1C) and 67-25(1D)), and

- non-resident entities carrying on business in Australia at or through a permanent establishment (subsection 67-25(1DA)).

114. Accordingly, a Scheme Shareholder who received the fully franked Interim Dividend and/or the Special Dividend is subject to the refundable tax offset rules in respect of each dividend unless they are listed specifically as one of the excluded entities under section 67-25. Generally, corporate tax entities (including companies, corporate limited partnerships, corporate unit trusts, and public trading trusts) will be excluded from the operation of the refundable tax offset rules.

Imputation benefits anti-avoidance provisions

Section 177EA

115. 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. In essence, it applies to schemes for the disposition of shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares.

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

117. Subsection 177EA(3) of the ITAA 1936 provides that section 177EA of the ITAA 1936 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 the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the 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.

118. Pepper is a corporate tax entity. The transfer of the shares in Pepper pursuant to the Scheme is a scheme for the disposition of membership interests. The fully franked Special Dividend is a frankable distribution that was paid to Scheme Shareholders (the relevant taxpayers) as a part of this scheme and who could, therefore, reasonably be expected to receive imputation benefits.

119. In the present case, it is considered that 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 (as provided for in subsection 177EA(17)), it would be concluded that, on the part of Pepper, its shareholders or any other relevant party, there is a purpose, more than merely an incidental purpose, of conferring an imputation benefit under the scheme.

120. In arriving at a conclusion, one 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 diverse matters which, taken individually or in conjunction with other matters, listed or not, could indicate the requisite purpose, that is, that the delivery of the imputation benefit is more than an incidental purpose of the scheme.

121. The relevant circumstances are that the disposition of the shares in Pepper was made pursuant to a takeover by Bidco by way of scheme of arrangement under the *Corporations Act 2001* voted upon by Pepper shareholders entitled to vote.

122. Pepper's scheme of arrangement is a normal commercial transaction under which Pepper shares are being acquired.

123. The fully franked Special Dividend was paid only to all the Cash Consideration recipients, which included a mix of residents and non-residents, in proportion to the number of shares that each such shareholder held on the Special Dividend Record Date and irrespective of their ability to utilise the relevant franking credits.

124. In considering the manner, form and substance of the scheme, it is considered that the scheme is not being entered into by Pepper or Scheme Shareholders for more than an incidental purpose of enabling Scheme Shareholders to obtain imputation benefits. The provision of imputation benefits to Scheme Shareholders remains incidental, in the sense of being subservient to, the purpose of transferring their shares to Bidco.

125. Having regard to the relevant circumstances of the scheme, it cannot be concluded that Pepper or Scheme Shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain an imputation benefit.

126. As such, the Commissioner considers 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 to be received in relation to the dividends.

Section 204-30

127. Section 204-30 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)), and
- (b) the member would *derive a *greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)), 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)).

128. Relevantly, if section 204-30 applies, the Commissioner has the discretionary power under subsection 204-30(3) to make a written determination.

129. Subsection 204-30(3) provides:

The Commissioner may make one or more of these determinations:

- (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;
- (b) that a specified *exempting debit arises in the *exempting account of the entity, for a specified *distribution or other benefit to a disadvantaged member;
- (c) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination.

A determination must be in writing.

130. 'Streaming' is not defined for the purposes of section 204-30. However, paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002 provides that 'streaming is selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits'.

131. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The words 'derive a greater benefit from franking credits' are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

132. Under the current arrangement, Scheme Shareholders that received the Special Dividend received an imputation benefit when the Special Dividend was paid. The imputation benefit for resident shareholders is in the form of a tax offset (paragraph 204-30(6)(a)), and for non-resident shareholders is in the form of not being liable to pay dividend withholding tax (paragraph 204-30(6)(e)). The resident shareholders may derive a greater benefit from franking credits than the non-resident shareholders.

133. However, the Special Dividend was paid equally to all Scheme Shareholders in receipt of the Cash Consideration and was fully franked regardless of their tax profiles. Accordingly, it cannot be said that Pepper selectively directed the flow of franked distributions to those members who could most benefit from the franking credits.

134. As the conditions in subsection 204-30(1) have not been met, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit received in relation to the Special Dividend.

Capital Gains Tax (CGT) consequences

CGT event A1

135. CGT event A1 happens if there is a change in the ownership of an asset from one entity to another (section 104-10). The time the event happens is either when a contract to dispose of the asset is entered into or, if there is no contract, when the change of ownership occurs (subsection 104-10(3)).

136. A Court approved scheme of arrangement does not involve a disposal of shares under a contract (paragraph 9 of Taxation Determination TD 2002/4 *Income tax: capital gains: what is the first element of the cost base and reduced cost base of a share in a company you acquire in exchange for a share in another company in a takeover or merger?*).

137. Accordingly, the time when CGT event A1 happened was when a Scheme Shareholder disposed of a Pepper share to Bidco on the Scheme Implementation Date of 4 December 2017 (paragraph 104-10(3)(b)).

138. The time when CGT event A1 happens determines the income year in which any capital gain or capital loss is made and whether the CGT discount applies to any capital gain.

139. A Scheme Shareholder makes a capital gain from CGT event A1 happening if the capital proceeds from the disposal of a Pepper share is more than the cost base of the Pepper share. A Scheme Shareholder makes a capital loss if those capital proceeds are less than the reduced cost base of the Pepper share (subsection 104-10(4)). The cost base and reduced cost base of a Pepper share depends on each Scheme Shareholders own circumstances.

Capital proceeds

140. The capital proceeds received by a Scheme Shareholder from a CGT event are the money and/or the market value of any property received or entitled to be received (worked out at the time of the event happening) in respect of the event happening (subsection 116-20(1)).

141. The capital proceeds Scheme Shareholders received for the disposal of a Pepper share was either the market value of each replacement Holdco Share received or the amount of Cash Payments received.

142. The term 'in respect of the event happening' in subsection 116-20(1) requires the relationship between the event and the receipt of the money or property, or the entitlement to receive the money or property, to be more than coincidental. An amount is not capital proceeds received or entitled to be received in respect of a CGT event merely because it is received in association with the CGT event.

143. However, in this case, the determination of the Special Dividend did not occur independently of the Scheme. It was a condition precedent to the Scheme. Payment of the Special Dividend was also contingent on the Pepper shareholders approving the Scheme. In this way, the Special Dividend is part of the sum of money in return for which the Pepper shareholders will have, by approving the Scheme of Arrangement, demonstrated their willingness to transfer their Pepper shares (paragraph 11 of Taxation Ruling TR 2010/4 *Income tax: capital gains: when a dividend will be included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement*).

144. In these circumstances, it is considered that the Special Dividend forms part of the capital proceeds which a Scheme Shareholder received in respect of CGT event A1 happening.

CGT Anti-overlap provision

145. For Scheme Shareholders that received the Cash Payments, a capital gain made from CGT event A1 happening to their Pepper shares is reduced by the amount of the Special Dividend that is included in their assessable income under section 44 of the ITAA 1936 (section 118-20). This has the effect of reducing (but not below zero) the capital gain by the amount that is assessable under another provision.

146. However, a capital gain is not reduced by the amount of the franking credit (attached to the Special Dividend) that is included in their assessable income under section 207-20 (paragraph 118-20(1B)(b)).

Availability of scrip for scrip roll-over if a capital gain is made

147. A tax consequence is the availability of scrip for scrip roll-over under Subdivision 124-M. It enables a shareholder to disregard a capital gain from a share that is disposed of as part of a corporate takeover or merger if the shareholder receives a replacement share in exchange. It also provides special rules for calculating the cost base and reduced cost base of the replacement share.

148. Subdivision 124-M contains a number of conditions for, and exceptions to, a shareholder being eligible to choose scrip for scrip roll-over. The main requirements that are relevant to the scheme that is the subject of this Ruling are:

- shares are exchanged for shares in another company
- the exchange is in consequence of a single arrangement
- conditions for the roll-over are satisfied
- further conditions, if applicable, are satisfied, and
- exceptions to obtaining scrip for scrip roll-over are not applicable.

149. The Scheme satisfies the conditions under Subdivision 124-M such that Scheme Shareholders that received replacement Holdco Shares, and made a capital gain from the disposal of the Pepper shares, may choose the roll-over, subject to the exceptions in paragraphs 150 and 151 of this Ruling.

150. Scrip for scrip roll-over cannot be chosen by a Scheme Shareholder that is a non-resident unless the replacement Holdco Shares are 'taxable Australian property' just after they were acquired (subsection 124-795(1)).

151. Scrip for scrip roll-over cannot be chosen if any capital gain the Scheme Shareholder might subsequently make from the replacement Holdco Shares would be disregarded, except because of a roll-over (subsection 124-795(2)).

Discount capital gain

152. If a Scheme Shareholder made a capital gain from the disposal of their Pepper share, the Scheme Shareholder may be eligible to treat the capital gain as a discount capital gain provided that all relevant requirements of Division 115 are met.

153. One of those requirements is that the capital gain must result from a CGT event happening to a CGT asset that was acquired by the entity making the capital gain at least 12 months before the CGT event (subsection 115-25(1)).

154. This means that a capital gain made by a Scheme Shareholder when they disposed of their Pepper share is a discount capital gain if the shareholder acquired the Pepper share at least 12 months before the date of disposal under the Scheme, being the Scheme Implementation Date of 4 December 2017, and the other requirements in Division 115 are satisfied.

Cost base of replacement Holdco Shares

155. The cost base and reduced cost base of a replacement Holdco Share acquired by a Scheme Shareholder in exchange for their Pepper share, is affected by whether the Scheme Shareholder chooses scrip for scrip roll-over.

Where scrip for scrip roll-over is not chosen

156. Where scrip for scrip roll-over is not chosen, the first element of the cost base and reduced cost base of each replacement Holdco Share is equal to the market value of each Pepper share given in exchange for the acquisition of a replacement Holdco Share (subsections 110-25(2) and 110-55(2)). The market value is worked out at the time of the acquisition (subsection 110-25(2)).

Where scrip for scrip roll-over is chosen

157. Where scrip for scrip roll-over is chosen, the first element of the cost base and reduced cost base of a replacement Holdco Share is worked out by reasonably attributing to it the cost base of the Pepper share for which it was exchanged and for which the roll-over was obtained (subsections 124-785(2) and 124-785(4)). In this case, due to the one-for-one exchange ratio, the existing cost base of the Pepper share becomes the cost base of the replacement Holdco Share.

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Not previously issued as a draft

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ATOlaw topic: Income tax ~~ Assessable income ~~ Dividend income ~~ Dividend income
Income tax ~~ Capital gains tax ~~ Capital proceeds
Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT event A1 - disposal of a CGT asset
Income tax ~~ Capital gains tax ~~ Rollovers ~~ Scrip for scrip - Subdivision 124-M
Offsets / rebates / credits / benefits ~~ Other offsets / rebates / benefits ~~ Franking tax offset

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