


TR 97/D10 - Income tax: capital gains: changes in majority underlying interests in assets of public entities for Division 20 of the Income Tax Assessment Act 1936

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Draft Taxation Ruling

Income tax: capital gains: changes in majority underlying interests in assets of public entities for Division 20 of the *Income Tax Assessment Act 1936*

other Rulings on this topic

IT 2361; IT 2530

| | |
|---|-----------|
| contents | para |
| What this Ruling is about | 1 |
| Ruling | 10 |
| Date of effect | 21 |
| Explanations | 22 |
| Effect of Taxation Rulings IT 2361 and IT 2530 | 47 |
| Detailed contents list | 70 |
| Your comments | 71 |

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DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

1. This Ruling is concerned with the discretionary powers that are given to the Commissioner of Taxation under subsections 160ZZSC(2) and 160ZZSD(2) and section 160ZZSQ of the *Income Tax Assessment Act 1936* ('the Act'). It is also concerned with the special tracing rules that are set out in sections 160ZZSJ to 160ZZST. Specifically, the Ruling:

- (a) lists matters that the Commissioner takes into account in exercising the discretion under subsection 160ZZSC(2) or 160ZZSD(2);
- (b) considers how an entity may rely on the special tracing rules in an application under subsection 160ZZSC(2) or 160ZZSD(2);
- (c) discusses the circumstances in which the Commissioner might consider exercising the discretion in section 160ZZSQ; and
- (d) outlines the use of the special tracing rules where subsection 160ZZSC(4) requires an entity to examine the underlying interests in its assets at a date earlier than 20 January 1997.

TR 97/D10

Class of person/arrangement

2. This Ruling applies to public entities to which section 160ZZSA applies. The Ruling does not apply to an entity for the purpose of determining how section 160ZZS applies to the entity in relation to assets disposed of before 20 January 1997. A separate Ruling about the application of section 160ZZS to public entities that disposed of assets before 20 January 1997 is now being prepared.

Key terms

3. In this Ruling:

'special tracing rules' refers to the rules set out in sections 160ZZSJ to 160ZZST;

'notional holder' means the fictional natural person referred to in subsection 160ZZSM(2) who may be treated as having the rights to certain dividends and distributions of capital from a public company, or to certain income or distributions of capital from a publicly traded unit trust.

4. The following terms used in this Ruling have the same meanings as they have in section 160ZZRR:

- abnormal trading
- base time
- listed public company
- majority underlying interests
- mutual insurance organisation
- public company
- public entity
- publicly traded unit trust
- test time
- underlying interest.

Background

5. Section 160ZZS determines when assets acquired by taxpayers (including public entities) before 20 September 1985 ('pre-CGT assets') lose their pre-CGT status as a result of a change in majority underlying interests held by natural persons. Schedule 4 of the *Taxation Laws Amendment Act (No 1) 1997* inserted a new Division 20 into Part IIIA of the Act which removed public entities

(public companies, publicly traded unit trusts and mutual insurance organisations) from the application of section 160ZZS. It also amended the way certain public entities determine whether pre-CGT assets become subject to the capital gains tax provisions because of a change in the majority underlying interests in those assets.

6. Division 20 requires public entities to determine, at certain prescribed times, whether the majority underlying interests in their pre-CGT assets are held by the same persons who held those interests at the base time (the last moment of 19 September 1985 or an alternative time within the period 1 July 1985 to 30 June 1986 that gives a reasonable approximation of underlying interests as at 19 September 1985). If the same persons did not hold the majority underlying interests in the assets at the base time and at the test time (ordinarily, the last moment of 20 January 1997 and at 5-yearly intervals after that day), the pre-CGT assets are taken to have been acquired at the test time or at an earlier time at which the public entity should have examined the underlying interests under section 160ZZS. The public entity is required to determine the cost base of the assets for capital gains tax purposes on the basis of their market value at the relevant time.

7. To assist in the determination, Subdivisions E, F and G of Division 20 contain special tracing rules that relieve public companies and publicly traded unit trusts of the need, in some circumstances, to identify the natural persons who hold the underlying beneficial interests in their pre-CGT assets.

8. Three provisions in the law (subsections 160ZZSC(2) and 160ZZSD(2) and section 160ZZSQ) give discretionary powers to the Commissioner. These provisions recognise that some entities may face difficulty in tracing the holders of underlying interests and that non-representative results may sometimes follow from the use of special tracing rules. If a public entity determines under subsection 160ZZSA(2) that the same persons did not hold the majority underlying interests in a pre-CGT asset at the base time and at a test time, the effect of subsections 160ZZSC(2) and 160ZZSD(2) is that that determination is disregarded if the Commissioner is satisfied, or considers it reasonable to assume, that the same persons did hold the majority underlying interests at both times. This could occur, for example, if a public company cannot fully trace through its shares to natural persons but can otherwise demonstrate that the same persons had continued to hold the majority underlying interests in the company's pre-CGT assets. The further discretionary power in section 160ZZSQ may result in a public company or publicly traded unit trust having to examine the underlying interests in its pre-CGT assets in greater detail - including interests of less than 1% - if the Commissioner reasonably assumes that the same persons did not hold

TR 97/D10

the majority underlying interests in an asset of the company or trust at the base time and at the test time.

9. This Ruling contains guidelines for the exercise of the discretions in subsections 160ZZSC(2) and 160ZZSD(2) and section 160ZZSQ but it is essential that each case is dealt with on its merits. Officers exercising the discretions should record in detail the matters they have taken into account in their exercise of them.

Ruling

Exercise by the Commissioner of the discretion under subsection 160ZZSC(2) or 160ZZSD(2)

10. Section 160ZZSA directs a public entity to which it applies to examine its records (and 'its records' may include information that the entity receives from related entities or other sources) and determine whether the same persons held the majority underlying interests in its pre-CGT assets at the base time and at a test time. Although a public entity makes a determination under section 160ZZSA that the majority underlying interests had not been maintained, it may have information that might satisfy the Commissioner that the same persons had held the majority underlying interests at both times. In that case it would be appropriate for the entity to apply to the Commissioner for exercise of the discretion under subsection 160ZZSC(2) or 160ZZSD(2).

11. When asking the Commissioner to exercise the discretion, the entity should state in detail the grounds for the application, and include all information that might indicate that the same persons have or have not continued to hold certain underlying interests and all information that could assist in making assumptions about the extent to which underlying interests have or have not continued to be held by the same persons.

12. The Commissioner takes into account the following matters (if they are relevant in the particular case) in deciding whether to exercise the discretion in subsection 160ZZSC(2) or 160ZZSD(2) in favour of a public entity:

- the time that has elapsed between the base time and the test time;
- the extent of trading in, or creation and cancellation of, shares, units or other membership interests of the entity;
- known changes in underlying interests and the extent of the underlying interests that have been shown not to have changed;

- known changes in registered interests in the entity and the extent of the registered interests that are known not to have changed;
- the nature and identity of registered shareholders, unitholders or members of the public entity;
- the nature and identity of registered shareholders, unitholders or members of an interposed entity;
- the extent of efforts made to identify underlying interests;
- the reasons why further tracing of underlying interests cannot or will not be carried out;
- the likelihood that further attempts to trace, if they were made, would be successful in identifying underlying interests;
- the state of records held, and the reasons for any deficiency in the records;
- the rationale for any exercise of a discretion under the Act or under the *Income Tax Assessment Act 1997* in relation to a public entity, or in relation to an entity that is related to the public entity, where the beneficial ownership of shares or units in the public entity was considered in exercising the discretion;
- details of any examination of beneficial ownership by the public entity, or by an entity that is related to the public entity, for the purposes of any provision of the Act or the *Income Tax Assessment Act 1997*;
- the extent of trading in, or creation and cancellation of, shares, units or other membership interests of entities that are interposed between the public entity and holders of underlying interests in its assets; and
- any other matter that is relevant to an exercise of the discretion in the circumstances of the particular case.

Reliance on the special tracing rules when applying for the discretion to be exercised

13. In making a case for consideration under subsection 160ZZSC(2) or 160ZZSD(2), a public company or publicly traded unit trust may ask the Commissioner to rely on the special tracing rules. If the Commissioner is satisfied, or considers it reasonable to assume, from the information supplied, that the same persons held the majority underlying interests in a pre-CGT asset of the company or trust at the

TR 97/D10

base time and at the test time, no further analysis is necessary of changes in individual interests.

14. On other occasions, it may only be by reviewing all information that the company or trust has, or can reasonably obtain, including for example, details of interests of less than 1% in the company's or trust's assets, that the Commissioner is in a position to make a decision under subsection 160ZZSC(2) or 160ZZSD(2).

Circumstances in which the discretion under section 160ZZSQ may be exercised

15. Section 160ZZSQ allows the Commissioner to prevent a public company or publicly traded unit trust from using the notional holder rule in a determination under Division 20 if the Commissioner considers it reasonable to assume that the majority underlying interests in the company's or trust's pre-CGT assets were not held by the same persons at the base time and at the test time. Unless there are exceptional circumstances, the Commissioner does not exercise the discretion under section 160ZZSQ if, at the test time, the notional holder had been taken to hold 20% or less of the underlying interests in a pre-CGT asset of the public company or publicly traded unit trust. Such exceptional circumstances only exist if, on an objective analysis of evidence available, it is clear that the same persons did not hold the majority underlying interests in a pre-CGT asset at the base time and at the test time. The special tracing rules under sections 160ZZSS and 160ZZST apply in the application of section 160ZZSQ.

16. Where the notional holder is taken to hold more than 20% of the underlying interests, the Commissioner is more likely to exercise the discretion if other evidence suggests that the same persons did not hold the majority underlying interests in a pre-CGT asset of the company or trust at the base time and at the test time. In other words, if the notional holder holds more than 20% of the underlying interests and, having regard to the matters referred to in subparagraphs 17(a) to (e) below, it is reasonable to assume that there has been a change in the majority underlying interests, then it is likely that the discretion will be exercised.

17. In considering whether it is reasonable to assume that there had been a change in the majority underlying interests, the Commissioner takes into account:

- (a) the percentages of the underlying interests in the asset that the notional holder is taken to have held at the base time and the test time;
- (b) the period between the base time and the test time;

- (c) the extent to which new interests have been created, existing interests terminated or interests traded in the asset between the base time and the test time;
- (d) the extent of the changes between the base time and the test time in the underlying interests in the asset held by persons other than the notional holder; and
- (e) any other available information that is material.

Extended use of the special tracing rules

18. A public entity may be required under subsection 160ZZSC(4) to determine whether the same persons held the majority underlying interests in a pre-CGT asset at the base time and at some other time before 20 January 1997. Subsection 160ZZSC(4) applies if it would have been appropriate for the public entity to examine the underlying interests in a pre-CGT asset having regard to the advice contained in Taxation Ruling IT 2361 or IT 2530.

19. The Commissioner accepts the use by public companies and publicly traded unit trusts of the special tracing rules in sections 160ZZSS and 160ZZST in making a determination under subsection 160ZZSC(4).

20. In general, public companies and publicly traded unit trusts may also adopt the notional holder rules in sections 160ZZSK to 160ZZSP in making a determination under subsection 160ZZSC(4). However, the rules are not to be used if the notional holder would be taken, on the day in respect of which the determination is made, to hold more than 20% of the underlying interests in a pre-CGT asset of the company or trust and, having regard to the matters listed in paragraph 17 of this Ruling, it is reasonable to assume that the same persons did not hold the majority underlying interests in the asset at the base time and on that day. Where the notional holder would be taken to hold 20% or less of the underlying interests, the rules may be used unless it is clear on the available evidence that the same persons did not hold the majority underlying interests in the asset at the base time and on the day in respect of which the determination is made.

Date of effect

21. This Ruling has effect from 20 January 1997 and applies to the 1996-97 or a later income year.

TR 97/D10

Explanations

Exercise by the Commissioner of the discretion under subsection 160ZZSC(2) or 160ZZSD(2)

22. It is not possible to outline all the matters that might be relevant in considering an application under subsection 160ZZSC(2) or 160ZZSD(2). Each case has to be decided on its own merits. Matters that are often relevant to, but not necessarily determinative of, the way the discretion is exercised include:

The time that has elapsed between the base time and the test time

23. Majority interests may be eroded in the course of day-to-day trading of an entity's shares or units in the market or (for membership interests that are not transferable) in the course of the creation and cancellation of interests. The more trading, issues and cancellations occur, with the passage of time, the more likely it is that majority underlying interests may have changed.

24. The time that has elapsed between the base time and the test time needs to be considered in conjunction with a second matter for consideration:

The extent of trading in, or creation and cancellation of, shares, units or other membership interests of the entity

25. Information about the volume of normal day-to-day trading, creation and cancellation of interests in a public entity provides some indication of whether a majority of the membership interests might change hands. Any transactions outside the normal course of trading, creation and cancellation of interests are also taken into account. For example, if over the period between the base time and the test time, a period of at least 12 years, there has been an annual 15% turnover in a company's shares, this may indicate that there has been a change in majority underlying interests in the assets of the company.

Known changes in underlying interests and the extent of the underlying interests that have been shown not to have changed

26. In every case it is likely that some underlying interests are known to have changed, and some are known not to have changed since 19 September 1985 and there are other interests that were held at the base time or the test time by persons who have not been identified, so that the public entity cannot show whether or not those interests have continued to be held by the same persons. In an application

under subsection 160ZZSC(2) or 160ZZSD(2), the public entity needs to provide information to enable the Commissioner to be satisfied that more than 50% of the underlying interests in its pre-CGT assets - comprising the interests that are known not to have changed and some of the unidentified interests - have been held by the same persons since 19 September 1985.

27. If, for example, 45% of the underlying interests in a public entity's pre-CGT assets are known not to have changed, and only 10% are known to have changed, little further information might be needed to satisfy the Commissioner that the majority underlying interests are still held by the same persons. On the other hand, if 40% of the underlying interests are known to have changed, and only 35% are known not to have changed, more detailed information might be needed about the 25% of underlying interests that are unidentified.

Known changes in registered interests in the entity and the extent of the registered interests that are known not to have changed

28. Because of the nature of certain entities that own shares, units or other membership interests, a public entity may be unable to identify a significant number of the underlying interests in its pre-CGT assets. This might be the case, for example, for entities that have a strong representation of overseas entities, nominees and the like among their memberships. In these circumstances the Commissioner may be able to make assumptions about the likely extent of changes in underlying interests by comparing records of persons and entities that were registered owners of the entity's shares, units or other membership interests at the base time with similar records at the test time. Records showing the extent to which registered shareholders, unitholders or members have continued to hold interests in the entity are not a conclusive factor, but are taken into account in the light of all available information.

The nature and identity of registered shareholders, unitholders or members of the public entity

The nature and identity of registered shareholders, unitholders or members of an interposed entity

29. Certain classes of persons who hold interests in public entities are more likely than others to hold those interests for long periods. Some become shareholders, unitholders or members of large public entities to secure a regular income, or as a form of superannuation. At the opposite end of the spectrum, some persons - who may hold more substantial interests - tend to acquire those interests to serve short term objectives. According to the extent to which each class of persons

TR 97/D10

holds interests in pre-CGT assets of a public entity, it may be possible to make reasonable inferences about the length of time for which certain interests are likely to have been held.

30. Where interests in the pre-CGT assets of a public entity are held indirectly through one or more interposed companies or trusts, the public entity may have difficulty discovering which of the interests have had the same beneficial owners over a long period of time. In this situation we may be able, using information about the average length of time that interests are held through companies or trusts of that kind, to estimate how likely it is that some of the interests have been beneficially held by the same persons since the base time.

The extent of efforts made to identify underlying interests

The reasons why further tracing of underlying interests cannot or will not be carried out

The likelihood that further attempts to trace, if they were made, would be successful in identifying underlying interests

31. An entity that applies for a discretion to be exercised should do everything that it reasonably can to establish that there is a genuine need for the discretion to be exercised and to construct a sound basis for its exercise. In particular cases there might be good reasons why entities decide that it would be pointless or unjustifiable to attempt to trace further. It may be that, because of the nature or location of particular shareholders, unitholders or members, further tracing would be difficult. Or there may be some prospect that further tracing would be successful, but at a high cost. Circumstances of these kinds, along with the other factors mentioned in this section of the Ruling, are taken into account in exercising the discretion.

The state of records held, and the reasons for any deficiency in the records

32. To compare the persons who held the underlying interests in their pre-CGT assets at the base time and at a test time, public entities need to have created and retained certain records. Some entities may have destroyed relevant records for the period from 1 July 1985 to 30 June 1986 (in which the base time occurs), or failed to compile the necessary records. The Commissioner takes into account the reasons for any lack of records which may affect the public entity's ability to identify the underlying interests in its assets.

The rationale for any exercise of a discretion under the Act or under the Income Tax Assessment Act 1997 in relation to a public entity, or in relation to an entity that is related to the public entity, where the beneficial ownership of shares or units in the public entity was considered in exercising the discretion

Details of any examination of beneficial ownership by the public entity, or by an entity that is related to the public entity, for the purposes of any provision of the Act or the Income Tax Assessment Act 1997

33. When a company attempts to satisfy the requirements of section 80A of the Act or Subdivision 166-F of the *Income Tax Assessment Act 1997* to enable a loss to be deducted from its assessable income, the examination of beneficial ownership that is done is similar, although not identical, to the examination required under Division 20 of Part IIIA in respect of beneficial interests. There are also other provisions of the Act, including, for example, the provisions relating to bad debts and capital losses, under which beneficial interests may be examined. Records and information considered under any of these provisions under which beneficial interests are examined, and the decision taken in respect of the provision, may throw light on whether there has been a continuity of underlying interests from the base time to a test time.

The extent of trading in, or creation and cancellation of, shares, units or other membership interests of entities that are interposed between the public entity and holders of underlying interests in its assets

34. Where an entity is interposed between a public entity and the persons who hold the underlying interests in its assets, it is relevant to take into account available information about transactions in the shares, units or memberships of the interposed entity.

Any other matter that is relevant in the circumstances of the particular case

35. Public entities should not limit the information they provide in an application under subsection 160ZZSC(2) or 160ZZSD(2) to the matters listed in this Ruling. When considering an application, we take into account any matter that is relevant to an exercise of the discretion in the circumstances of the particular case. An entity should state, fully and in detail, the grounds for the application, including all information it has:

TR 97/D10

- (a) that might indicate the same persons have or have not continued to hold certain underlying interests; or
- (b) that could assist us in drawing inferences on a reasonable basis about the extent to which underlying interests have or have not continued to be held by the same persons.

For example, we take into account any statistical information about the known ownership of shares in a listed public company or units in a publicly traded unit trust that is reasonably capable of being applied to an unknown shareholding in the company or unitholding in the trust.

36. We take the view that in exercising the discretion under subsection 160ZZSC(2) or 160ZZSD(2), the Commissioner should not take into account subsection 160ZZSA(3), which in certain circumstances treats the underlying interests in an asset as having been held by different persons at the base time and at the test time.

Reliance on the special tracing rules when applying for the discretion to be exercised

37. At each test time at which Division 20 applies to a public entity, the entity must make a determination showing whether the majority underlying interests in its pre-CGT assets were held by the same persons who held the majority underlying interests at the base time. If the public entity is a public company or publicly traded unit trust, it may make the determination using the special tracing rules in Subdivisions E, F and G of Division 20. Using these rules the public company or publicly traded unit trust may:

- treat shareholder interests of less than 1% in a public company or unitholder interests of less than 1% in a publicly traded unit trust as if they were held by a single natural person, known as the notional holder;
- treat certain funds or special companies with more than 50 members, and government bodies, as if the fund, special company or government body were a natural person holding interests for its own benefit;
- treat underlying interests that are held through funds or special companies with 50 or fewer members as if they were held by those members in equal proportions; and
- make certain assumptions about interests held through a public company or publicly traded unit trust that had ceased to be a mutual insurance organisation between the base time and a particular test time.

38. A public company or publicly traded unit trust that makes a determination showing that the majority underlying interests in its pre-CGT assets were not held by the same persons at the base time and at the test time may apply to the Commissioner to exercise the discretion under subsection 160ZZSC(2) or 160ZZSD(2). Often, a company or trust that asks for the discretion to be exercised has adopted one or more of the special tracing rules in examining the majority underlying interests in its assets. For example, individual interests of less than 1% may have been treated as having been held collectively by a notional holder at the base time and at the test time; or the underlying interests in shares or units held by a complying superannuation fund or approved deposit fund with more than 50 members may have been assumed not to have changed.

39. In making a case for consideration under subsection 160ZZSC(2) or 160ZZSD(2), a public company or publicly traded unit trust may ask us to rely on the special tracing rules. If the Commissioner is satisfied, or considers it reasonable to assume, from the information supplied that the same persons held the majority underlying interests in a pre-CGT asset of the company or trust at the base time and at the test time, no further analysis is necessary of changes in individual interests.

40. Where, after examination of a company's or trust's submissions, there remains some doubt whether the same persons held the majority underlying interests at the base time and at the test time, the Commissioner may ask for further information. The particulars asked for could include, for example, details of interests of less than 1% in the company or trust's assets - those interests that were attributed to a notional holder. On occasions, it may only be by reviewing all such information that the entity has, or can reasonably obtain, that the Commissioner will be in a position to make a decision under subsection 160ZZSC(2) or 160ZZSD(2).

Circumstances in which the discretion under section 160ZZSQ may be exercised

41. If the Commissioner considers it reasonable to assume that the same persons did not hold the majority underlying interests in a pre-CGT asset owned by a public company or publicly traded unit trust at the base time and at a test time, section 160ZZSQ provides that the notional holder rules in sections 160ZZSK to 160ZZSP are not available to the company or trust. Section 160ZZSQ is, in a sense, the opposite of subsections 160ZZSC(2) and 160ZZSD(2):

- subsections 160ZZSC(2) and 160ZZSD(2) enable the Commissioner to override a determination by a public

TR 97/D10

entity that the same persons had not continued to hold the majority underlying interests in its pre-CGT assets where it is reasonable to assume that the same persons have continued to hold the majority underlying interests in the assets;

- section 160ZZSQ may result in the Commissioner overriding a determination by a public entity that the same persons had continued to hold the majority underlying interests in its pre-CGT assets where it is reasonable to assume that the same persons have not continued to hold the majority underlying interests in the assets.

42. The following guidelines help public entities decide whether the discretion in section 160ZZSQ is likely to be exercised in their case for the purposes of Division 20. Generally, the discretion is unlikely to be exercised by the Commissioner where the notional holder has 20% or less of the underlying interests. The Commissioner only exercises the discretion in these cases if, on an objective analysis of the evidence, it is clear that the same persons did not hold the majority underlying interests.

43. The discretion is more likely to be exercised where the notional holder has more than 20% of the underlying interests. However, the Commissioner must take into account the available information in order to determine whether it is reasonable to assume that the same persons did not hold the majority underlying interests. The following factors are relevant in this regard:

- (a) the percentages of the underlying interests in the asset that the notional holder would be taken to have held at the base time and at the test time;
- (b) the period between the base time and at the test time;
- (c) the extent to which new interests have been created, existing interests terminated or interests traded in the asset between the base time and at the test time;
- (d) the extent of the changes between the base time and the test time in the underlying interests in the asset held by persons other than the notional holder; and
- (e) any other available information that is material.

For example, a public entity where the notional holder holds a large percentage of the underlying interests might be able to satisfy the Commissioner, having regard to the factors above and, where appropriate, statistically sound sampling techniques, that the majority underlying interests have been maintained.

Extended use of the special tracing rules

44. Division 20 provides for special tracing rules to be available, at the option of a public company or publicly traded unit trust, for the purpose of subsection 160ZZSA(2) in determining the natural persons who held interests in the company's or trust's pre-CGT assets at the base time and at the test time. There are, however, other dates at which, under Division 20, public entities may need to examine the underlying interests in their pre-CGT assets. Subsection 160ZZSC(4) requires a public entity to identify the earliest day on which it was required in practice to examine the underlying interests in its pre-CGT assets before 20 January 1997, having regard to relevant public rulings (Taxation Rulings IT 2361 and IT 2530) and on which it is unable to show that the majority underlying interests had been maintained. The special tracing rules can be used by public companies and publicly traded unit trusts for the purpose of complying with subsection 160ZZSC(4), subject to the same safeguards as apply under Subdivision E of Division 20.

45. Where a superannuation fund, approved deposit fund, special company, government body or former mutual insurance organisation holds an interest in the assets of a public company or publicly traded unit trust, the company or trust may, if it chooses, apply the special rules in sections 160ZZSS and 160ZZST to determine the underlying interests in its pre-CGT assets under subsection 160ZZSC(4). A former mutual insurance organisation (which has become a public company or a publicly-traded unit trust since the base time) may also apply the rules in section 160ZZST when examining the underlying interests in its own pre-CGT assets for the purposes of subsection 160ZZSC(4).

46. Public companies and publicly traded unit trusts may also adopt the notional holder rules in sections 160ZZSK to 160ZZSP in making a determination under subsection 160ZZSC(4). However, these special tracing rules should not be used:

- where the notional holder would be taken to hold 20% or less of the underlying interests, and it is clear on the available evidence that the same persons did not hold the majority underlying interests in the asset at the base time and on the day in respect of which the determination is made; or
- where the notional holder would be taken to hold more than 20% of the underlying interests in a pre-CGT asset of the company or trust and, having regard to the matters listed in paragraph 17 of this Ruling, it would be reasonable to assume that the same persons did not hold the majority underlying interests in the asset at the base

TR 97/D10

time and on the day in respect of which the determination is made.

Effect of Taxation Rulings IT 2361 and IT 2530

47. Subsection 160ZZSC(4) in Division 20 refers back to the way Taxation Rulings IT 2361 and IT 2530 applied before 20 January 1997. Subsection 160ZZSC(4) requires 'public entities' to determine whether, having regard to section 160ZZS and either of those Rulings, it would have been appropriate for them to have examined the underlying interests in their pre-CGT assets. If a particular entity should have examined the underlying interests in its pre-CGT assets, and the entity is unable to show that at that time the majority underlying interests were held by the same persons who held the majority underlying interests at the base time, the assets are taken to have been acquired at that time.

48. In the past, there have been different views about some aspects of Taxation Rulings IT 2361 and IT 2530. Views have been put forward about what the Rulings meant when they referred to 'normal transactions' in the shares of a public company or the units of a publicly traded unit trust. There have been questions about how wide the classes of entities are that were affected by each of the Rulings.

Classes of entities covered

49. In our view, all 'public entities' were covered by Taxation Rulings IT 2361 and IT 2530. The Rulings indicated that the Commissioner would be satisfied in respect of two classes of entities, referred to as 'public companies' and 'publicly traded unit trusts', that majority underlying interests in their pre-CGT assets had been maintained except when there was activity in the nature of a takeover or merger, or there were other major changes in the ownership of shares or units outside the conduct of normal trading in the shares or units. These Rulings did not provide any protection from administrative action for all other entities which were required by section 160ZZS to examine continually the underlying interests in their pre-CGT assets.

50. Taxation Ruling IT 2361, in referring to 'public companies', meant those public companies whose shares are traded on a stock exchange. This intention can be seen from paragraph 4 of the Ruling which distinguishes normal transactions in a company's shares on a stock exchange from major changes in ownership of shares which

occur outside the conduct of normal stock market trading. There was no discussion in the Ruling of an exemption for companies whose shares are not normally traded on a stock exchange. The Ruling was only intended to give a concession to listed public companies.

51. This interpretation of the Ruling is consistent with Taxation Ruling IT 2530, which made parallel arrangements for certain unit trusts. It expressly defines a unit trust to which it applies as one of 'the units in which are listed for quotation in the official list of a stock exchange in Australia or elsewhere, or are ordinarily available for subscription or purchase by the public'.

52. It follows that the Rulings, in a practical sense, relieved listed public companies and publicly traded unit trusts from the obligation to monitor normal stock market transactions in their shares or units, or to monitor normal subscriptions or purchases of units in the case of certain publicly traded unit trusts, so long as they were not associated with activity in the nature of a takeover or merger. Other major changes that occurred outside the conduct of normal market trading still needed to be examined.

53. There was some guidance in paragraph 9 of Taxation Ruling IT 2530 for companies in which a listed public company or publicly traded unit trust has a direct or indirect interest.

Companies that are owned by other public entities

54. The definition of 'public company' in section 160ZZRR includes as a public company for the purposes of Division 20:

- '(a) ...
- (b) a company (other than a listed public company) all the shares in which are beneficially owned by any one or more of the following:
 - (i) listed public companies;
 - (ii) mutual insurance organisations;
 - (iii) publicly traded unit trusts; or
- (c) a 100% subsidiary of a company to which paragraph (b) applies.'

Most companies that are public companies under paragraph (b) or paragraph (c) would previously have looked to paragraph 9 of Taxation Ruling IT 2530 for guidance as to what would satisfy the Commissioner that there was no change in the majority underlying interests. Paragraph 9 advised a company to assume that each listed public company or publicly traded unit trust that held its shares, or had

TR 97/D10

an indirect interest in its shares, had maintained a continuity in the majority underlying interests in its own assets, so long as there had only been normal transactions in the public company's shares or the trust's units and these transactions were not associated with activity in the nature of a takeover or merger.

55. One purpose of paragraph 9 of Taxation Ruling IT 2530 was to relieve companies from the need to monitor the underlying interests in their pre-CGT assets continually if they had been wholly owned, directly or indirectly, by the same listed public company or publicly traded unit trust since before 20 September 1985. They only needed to examine the underlying interests when the listed public company or publicly traded unit trust examined the underlying interests in its own assets. This concession applied to companies that fall within paragraph (b) of the definition of 'public company' in which all the shares are beneficially owned by a single listed public company or a single publicly traded unit trust, and companies within paragraph (c) that are 100% subsidiaries of these companies.

56. The practical effect of paragraph 9, therefore, was that these wholly-owned companies should have determined whether there had been a change in the majority underlying interests in their assets when there was activity in the nature of a takeover or merger, or other major changes in the ownership of the shares or units outside the conduct of normal trading, in the parent listed public company or publicly traded unit trust. Subsection 160ZZSC(4) now requires a public entity to identify the earliest day on which it was required to determine the majority underlying interests in its pre-CGT assets and on which it is unable to show that majority underlying interests have been maintained. For these wholly-owned companies, that day is the same day that the parent company or trust identifies for its own assets.

57. Different issues arise for companies that fall within paragraph (b) of the definition of 'public company' and the shares in which are beneficially owned by more than one listed public company, mutual insurance organisation or publicly traded unit trust. The application of subsection 160ZZSC(4) to these companies needs to be considered on a case by case basis.

When did obligations arise under the Rulings?

58. Taxation Ruling IT 2361 issued on 18 September 1986 and Taxation Ruling IT 2530 issued on 4 May 1989. To avoid any inconsistency in the way subsection 160ZZSC(4) applies to the listed public companies and to the publicly traded unit trusts, we accept that for entities falling within the terms of these Rulings it was not necessary to examine the underlying interests in pre-CGT assets until

4 May 1989. Public entities that are required to examine their records at a date earlier than 20 January 1997 because of subsection 160ZZSC(4) will therefore not need to take into account events in the nature of takeover, merger or other major transaction before 4 May 1989.

The meaning of 'normal transactions'

59. Subsection 160ZZSC(4) applies to a company or trust only if it was appropriate, having regard to the Rulings, for that company or trust to examine the majority underlying interests in its pre-CGT assets.

60. Paragraph 4 of Taxation Ruling IT 2361 advised taxpayers that a listed public company need not examine the majority underlying interests in its pre-CGT assets for the purposes of section 160ZZS as long as there were only normal transactions in its shares on a stock exchange that were not associated with activity in the nature of a takeover or merger. It went on:

'Major changes in the ownership of shares which occur outside the conduct of normal stock market trading, however, will call for careful examination, in the course of which regard will be paid to changes in shareholdings that have occurred in the course of normal trading on stock exchanges as well as to those related to the events that caused the examination to be made.'

Paragraph 5 of Taxation Ruling IT 2530 provided similar advice in relation to publicly traded unit trusts.

61. Paragraph 6 of Taxation Ruling IT 2530 explained how the Rulings applied to the issue of additional units in a unit trust or additional shares in a listed public company. It advised that these were not to be treated as part of the normal trading of units or shares.

62. It follows that if there was any transaction associated with activity in the nature of a takeover or merger, or any major change in the ownership of shares or units that was outside the conduct of normal trading, or any issue of additional shares or additional units, then the listed public company or publicly traded unit trust was required by law to make an examination of the majority underlying interests in its pre-CGT assets.

63. An **alternative view** has been argued that the Rulings should be read as requiring the underlying interests to be examined only where there were transactions in a company's shares or a trust's units related to a takeover or merger or that there was no need to examine underlying interests unless there were 'major changes' of ownership, whether in the market or through issues of additional shares or units.

TR 97/D10

Normal transactions under subsection 160ZZSC(4)

64. In our view the Rulings indicated that listed public companies and publicly traded unit trusts continued to be required to examine the majority underlying interests in their pre-CGT assets in circumstances where there was:

- trading in the company's shares or trust's units that was related to an attempted takeover or merger (whether or not it was successful);
- any issue of new shares or units, including under a dividend reinvestment plan or by way of a bonus issue;
- any buy-back of shares or units or capital reduction; or
- any other major transaction in the company's shares or the trust's units that did not take place on a stock exchange, or (if the units in a particular publicly traded unit trust are not traded on a stock exchange) any major transaction outside the normal course of subscriptions, purchases and cancellations of units.

65. Subdivision D of Division 20 recognises that there have been considerable changes in the way shares and units are traded or new shares and units are issued. In sections 160ZZSF to 160ZZSI in Subdivision D there are new tests for deciding what is abnormal trading that are more flexible than the rules in Taxation Rulings IT 2361 and IT 2530.

66. Before Division 20 was enacted, our view was that section 160ZZS required a listed public company or publicly traded unit trust to examine the majority underlying interests in its pre-CGT assets if there was any transaction in its shares or units associated with a takeover or merger, any major change in the ownership of its shares or units that was outside the conduct of normal trading, or any issue of additional shares or additional units. However, for the purposes of subsection 160ZZSC(4), we do not insist on an examination of the majority underlying interests where the particular transaction would not have been 'abnormal trading' if Subdivision D of Division 20 had been in force at that time. As a result, subsection 160ZZSC(4) is taken to apply to listed public companies and publicly traded unit trusts if both:

- (a) the company or trust, having regard to the Rulings, should have examined the underlying interests in its assets at a time before 20 January 1997; and
- (b) the transaction in its shares or units that took place at that time was 'abnormal trading' under Division 20.

67. As a further concession, we also accept for the purposes of subsection 160ZZSC(4) that a listed public company or publicly traded unit trust was not required to examine the majority underlying interests in its pre-CGT assets when:

- (a) the company or trust issued bonus shares or units, so long as all shareholders or unitholders were offered a number of shares or units in proportion to their existing holdings of ordinary shares in the company or units in the trust;
- (b) rights to acquire shares in the company or rights to acquire units in the unit trust are exercised, so long as all shareholders or unitholders were offered a number of rights in proportion to their existing holdings of ordinary shares in the company or units in the trust;
- (c) the company or trust issued shares or units under a dividend reinvestment plan, so long as all shareholders or unitholders were offered a number of rights in proportion to their existing holdings of ordinary shares in the company or units in the trust; or
- (d) the company issued shares under an employee share acquisition scheme if the value of shares issued under the scheme in any year amounted to less than 5% of the company's existing issued share capital.

68. Changes in underlying interests that occur as a result of a transaction referred to in paragraph 67, however, need to be taken into account at any later time when the listed public company or publicly traded unit trust was not relieved under the Rulings from examining the underlying interests in its pre-CGT assets.

69. For publicly traded unit trusts the units in which were not traded on a stock exchange, the cancellation of units or issue of units to new applicants in the course of normal day-to-day operations is treated as being equivalent to the normal trading of units on a stock exchange, so long as the cancellation or issue of units was not:

- (a) associated with an attempted takeover or merger of the trust; or
- (b) done to enable the trustee to acquire property in its capacity as trustee of the trust.

Detailed contents list

70. Below is a detailed contents list for this Draft Ruling.

TR 97/D10

| | paragraph |
|--|-----------|
| What this Ruling is about | 1 |
| Class of person/arrangement | 2 |
| Key terms | 3 |
| Background | 5 |
| Ruling | 10 |
| Exercise by the Commissioner of the discretion under subsection 160ZZSC(2) or 160ZZSD(2) | 10 |
| Reliance on the special tracing rules when applying for the discretion to be exercised | 13 |
| Circumstances in which the discretion under section 160ZZSQ may be exercised | 15 |
| Extended use of the special tracing rules | 18 |
| Date of effect | 21 |
| Explanations | 22 |
| Exercise by the Commissioner of the discretion under subsection 160ZZSC(2) or 160ZZSD(2) | 22 |
| <i>The time that has elapsed between the base time and the test time</i> | 23 |
| <i>The extent of trading in, or creation and cancellation of, shares, units or other membership interests of the entity</i> | 25 |
| <i>Known changes in underlying interests and the extent of the underlying interests that have been shown not to have changed</i> | 26 |
| <i>Known changes in registered interests in the entity and the extent of the registered interests that are known not to have changed</i> | 28 |
| <i>The nature and identity of registered shareholders, unitholders or members of the public entity</i> | 29 |
| <i>The nature and identity of registered shareholders, unitholders or members of an interposed entity</i> | 29 |
| <i>The extent of efforts made to identify underlying interests</i> | 31 |
| <i>The reasons why further tracing of underlying interests cannot or will not be carried out</i> | 31 |
| <i>The likelihood that further attempts to trace, if they were made, would be successful in identifying underlying interests</i> | 31 |

| | |
|--|-----------|
| <i>The state of records held, and the reasons for any deficiency in the records</i> | 32 |
| <i>The rationale for any exercise of a discretion under the Act or under the Income Tax Assessment Act 1997 in relation to a public entity, or in relation to an entity that is related to the public entity, where the beneficial ownership of shares or units in</i> | 33 |
| <i>Details of any examination of beneficial ownership by the public entity, or by an entity that is related to the public entity, for the purposes of any provision of the Act or the Income Tax Assessment Act 1997</i> | 33 |
| <i>The extent of trading in, or creation and cancellation of, shares, units or other membership interests of entities that are interposed between the public entity and holders of underlying interests in its assets</i> | 34 |
| <i>Any other matter that is relevant in the circumstances of the particular case</i> | 35 |
| Reliance on the special tracing rules when applying for the discretion to be exercised | 37 |
| Circumstances in which the discretion under section 160ZZSQ may be exercised | 41 |
| Extended use of the special tracing rules | 44 |
| Effect of Taxation Rulings IT 2361 and IT 2530 | 47 |
| Classes of entities covered | 49 |
| Companies that are owned by other public entities | 54 |
| <i>When did obligations arise under the Rulings?</i> | 58 |
| The meaning of 'normal transactions' | 59 |
| Normal transactions under subsection 160ZZSC(4) | 64 |
| Detailed contents list | 70 |
| Your comments | 71 |

Your comments

71. If you wish to comment on this draft Ruling please send your comments by: 12 September 1997

to:

TR 97/D10

page 24 of 24

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- takeover

- test time

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- tracing of ownership and interests

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legislative references

- ITAA36 80A
- ITAA36 160ZZRR
- ITAA36 Pt IIIA Div 20
- ITAA36 160ZZS
- ITAA36 160ZZSA
- ITAA36 160ZZSA(2)
- ITAA36 160ZZSA(3)
- ITAA36 160ZZSC(2)
- ITAA36 160ZZSC(4)
- ITAA36 160ZZSD(2)
- ITAA36 160ZZSF
- ITAA36 160ZZSI
- ITAA36 160ZZSJ
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- ITAA36 160ZZST

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reference number

subject references

- abnormal trading
- approved deposit fund
- base time
- capital gains
- continuity of majority underlying interests
- cost base
- discretion
- government bodies
- merger
- mutual insurance organisations
- notional single shareholder or unitholder
- public company
- public entities
- publicly traded unit trusts
- special companies
- superannuation fund

case references