TR 97/18A - Addendum - Income tax: capital gains: roll-over relief following reorganisation of the affairs of a unit trust or company - sections 160ZZPA, 160ZZPB, 160ZZPC and 160ZZPD

Addendum

Taxation Ruling

Income tax: capital gains: roll-over relief following reorganisation of the affairs of a unit trust or company – sections 160ZZPA, 160ZZPB, 160ZZPC and 160ZZPD

This Addendum amends the views in Taxation Ruling TR 97/18 (the Ruling) on the availability of roll-over where there are schemes for reorganising the affairs of more than one entity. It also clarifies the way the roll-over provisions interact generally with the consolidation rules in Part 3-90 of the *Income Tax Assessment Act 1997* (ITAA 1997).

The views in the Ruling apply equally to the rewritten roll-over provisions in Subdivisions 124-G and 124-H of the ITAA 1997.

Taxation Ruling 97/18 is amended as follows:

1. The parts of the Ruling which state that roll-over relief is not available where more than one entity is reorganised, particularly paragraph 16 and paragraphs 42 to 52, are directed at restructures in the nature of 'mergers' or 'amalgamations' described at paragraphs 27 to 41 of the Ruling. They do not exclude from the roll-over provisions reorganisations of entities that use the same interposed shelf company, and maintain economic interests in the underlying assets of each entity just after the reorganisation. Such a situation would arise where a non-operating holding company is interposed so that only the manner in which the operating companies are held changes.

2. Although the conditions for roll-over are expressed in the singular form, this does not mean that the reorganisation of the affairs of more than one entity will be ineligible for relief. Rather, it is considered that the legislation intended for each entity to be tested for compliance with the roll-over requirements independently of any other entity whose affairs are also reorganised and interposes the same shelf company.

3. When testing whether the requirements in sections 124-365 and 124-375 of the ITAA 1997 (or the equivalent provisions in Subdivision 124-H of the ITAA 1997) are met in respect of each reorganised company, the shares 'issued' in the interposed company to exchanging members are the total replacement shares issued to all exchanging members in exchange for their shares in all of the entities being reorganised.

4. For example, when applying paragraph 124-365(2)(b) in respect of each original company, each exchanging member must own:

- a proportion of the total replacement shares issued by the interposed company to all exchanging members for disposing of their shares in all of the original companies,

that is equal to:

- the proportion of the total shares in the original company disposed of to the interposed company, that the member owned.

5. Subsection 124-365(3) of the ITAA 1997 similarly requires the market value ratio worked out for each exchanging member in respect of their interest in an original company to equal the market value ratio of the member's interest in the total replacement shares issued by the interposed company.

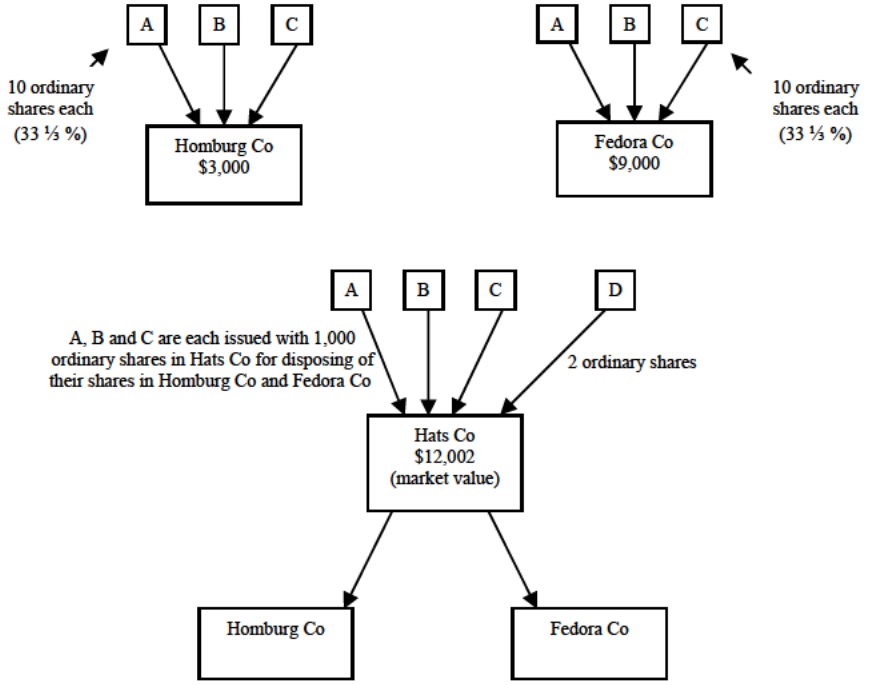
6. In effect, schemes for reorganising the affairs of more than one entity can only satisfy the legislative requirements for roll-over relief where:

- exchanging members are the same across each entity whose affairs are being reorganised;
- an exchanging member holds the same proportion of shares in each entity being reorganised; and
- the reorganisation of each entity occurs at the same time thus ensuring that a shelf company is interposed and that economic interests in the underlying assets of each entity are maintained just after its reorganisation.

Example 1

7. Shareholders A, B and C each owns 10 ordinary shares in Homburg Co. Each also owns 10 ordinary shares in Fedora Co. Assume that Homburg Co is worth $3,000 and Fedora Co $9,000.

8. It is proposed to interpose a non-operating holding company, Hats Co, between the 2 operating companies and their shareholders. Hats Co has only two $1 shares on issue, both are held by shareholder D. Under the scheme, shareholders A, B and C are each issued with 1,000 ordinary shares in Hats Co in exchange for all of their interests in Homburg Co and Fedora Co. Hats Co acquires all of the shares in Homburg Co and Fedora Co at the same time.



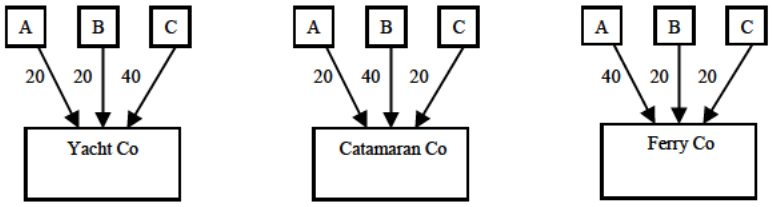
9. In this example, the economic interests held by exchanging members in the assets of Homburg Co and Fedora Co are maintained just after each reorganisation is completed.

- A, B and C each holds 33 ⅓% of the total replacement shares in Hats Co that were issued to all exchanging members under the scheme (that is, 1000/3000), which is equal to each shareholder's proportionate interest in the total Homburg Co shares disposed of to Hats Co (that is, 10/30) and the total Fedora Co shares disposed of to Hats Co (that is, 10/30).
- The ratio of the market value of each exchanging member's replacement shares in Hats Co to the market value of total replacement shares issued to all members is ⅓. This is the same as the market value ratio of each exchanging member's shares in Homburg Co, and in Fedora Co, as a proportion of total shares in each original company that were disposed of to Hats Co (that is, $1,000/$3,000 and $3,000/$9,000 respectively).

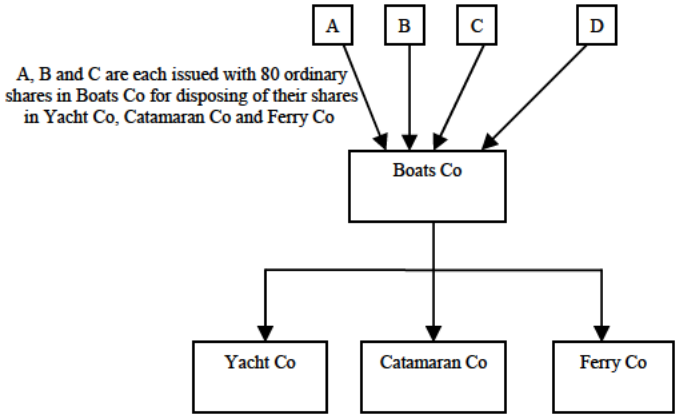
10. The exchanging members do not have an interest in any of the underlying assets in which they had no such interest immediately before the restructure. Their interests in the underlying assets of each original company are maintained immediately after the reorganisation is completed. Roll-over relief would therefore be available under Subdivision 124-G of the ITAA 1997.

Example 2

11. Shareholders A, B and C own all of the shares in Yacht Co, Catamaran Co and Ferry Co. Their respective shareholdings in each of the companies are shown below.



12. It is proposed to interpose a shelf company, Boats Co, between the 3 operating companies and their shareholders. Boats Co has only two shares on issue, both are held by shareholder D. Under the scheme, shareholders A, B and C are each issued with 80 ordinary shares in Boats Co in exchange for all of their interests in Yacht Co, Catamaran Co and Ferry Co. Boats Co acquires all of the shares in the three companies at the same time.



13. In this example, the interests held by exchanging members in the underlying assets of Yacht Co, Catamaran Co and Ferry Co are not maintained just after each reorganisation is completed.

14. Shareholders A and B each held 25% of the total Yacht Co shares disposed of to Boats Co, while shareholder C held 50%. Just after the reorganisation, A, B and C each holds 33 ⅓% of the total replacement shares in Boats Co that were issued to all exchanging members (that is, 80/240).

15. Shareholders A and B have therefore acquired an additional 8⅓% interest in the underlying assets of Yacht Co while C's interest has decreased. Each shareholder's interest in the underlying assets of Catamaran Co and Ferry Co had also changed just after the reorganisation of these entities was completed. Roll-over relief therefore would not be available under Subdivision 124-G of the ITAA 1997 for the reorganisation of any of the original companies.

Interaction between Subdivisions 124-G and 124-M (scrip-for-scrip)

16. Entities that are eligible for roll-over relief under Subdivision 124-G of the ITAA 1997, whether they choose to obtain the roll-over or not, are prevented from accessing scrip for scrip roll-over under Subdivision 124-M (see subsection 124-795(3) of the ITAA 1997). The views adopted in this Addendum may therefore mean:

- in some cases, a shareholder's pre-CGT interest in an original company may now be maintained under Subdivision 124-G (Subdivision 124-M does not provide relief in respect of pre-CGT interests unless CGT event K6 would have applied); and
- in other cases, the application of Subdivision 124-G may result in a different first element of cost base and reduced cost base for the interests held by the interposed company than would be provided by the ordinary CGT cost base rules if Subdivision 124-M applied.

Reorganising the affairs of the head company of a consolidated group

17. In some cases, the company whose affairs are to be reorganised under the scheme may be the head company of a consolidated group. If the interposed company (the new head company) wants the consolidated group to continue to exist, it must make a choice under subsection 124-380(5) of the ITAA 1997 to that effect (see also section 703-65 of the ITAA 1997). Otherwise, the ordinary rules in subsection 703-5(2) of the ITAA 1997 will apply to deconsolidate the group.

18. Whilst not expressly stated, it is considered that the choice under subsection 124-380(5) of the ITAA 1997 can only be made by an interposed company that is a shelf company. This is because the choice is only available where the reorganisation qualifies for roll-over relief and, for the reasons set out in the Ruling, this requires a shelf company to be interposed.

19. However, to the extent of any uncertainty, it is clear on reading the Act as a whole that it was intended the choice under subsection 124-380(5) be confined to a particular type of interposed company. For example, the note to subsection 703-5(2) and the group heading to sections 703-65 to 703-80 of the ITAA 1997, which set out the consequences of making a choice under subsection 124-380(5), both refer to the interposition of a shelf company between the head company and its former members.

20. The general rule is that, while these sorts of internal aids form part of the Act (subsection 950-100(1) of the ITAA 1997), they give way to the extent they are inconsistent with clear and unambiguous provisions. See Latham C.J. in *Silk Bros Pty. Ltd. v. State Electricity Commission (Vict.)* (1943) 67 CLR 1 (contrast Griffiths C.J. in *Saunders v. Borthistle* (1904) 1 CLR 379 at 389).

21. However, where the language of the section is clear and, although more generally expressed, is not inconsistent with the headings, the sections may be read subject to the headings (see Murray CJ in *Ragless v. Prospect District Council* [1922] SASR 299 at 311).

22. The scope of sections 703-65 to 703-80 of the ITAA 1997 must therefore be read as applying only to those choices made under subsection 124-380(5) by an interposed company that is also a 'shelf company'.

23. The group heading cannot, of its own, limit the operation of subsection 124-380(5) in the same way as sections 703-65 to 703-80 of the ITAA 1997. But as a matter of proper statutory construction, provisions dealing with who can make a choice, and the effects of making that choice, cannot be read in isolation.

24. Therefore, in reading subsection 124-380(5) as a whole with the other provisions of the Act, it follows that the provision must also be construed as allowing only shelf companies to make a choice under subsection 124-380(5). It is doubtful that Parliament would have intended to provide entities with a choice without also allowing the consequences that flow from making that choice to eventuate.

Meaning of 'shelf company'

25. 'Shelf company' is not defined for the purposes of the ITAA 1997.

26. Under its traditional meaning, a 'shelf company' is a registered company that is inactive and available for purchase by those who wish to avoid the delay involved in incorporating a new company themselves (Macquarie Dictionary).

27. However, for the purposes of interpreting sections 703-65 to 703-80 of the ITAA 1997, the meaning of 'shelf company' must be determined from the context in which it is used.

28. We think that in the context of sections 703-65 to 703-80 of the ITAA 1997, 'shelf company' simply refers to a company that has never commenced trading activities, has no significant assets other than a small amount of cash or debt and has no existing losses.

Date of effect

29. This Addendum applies before and after its date of issue. However, it does not apply to the extent it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the final Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

30. It also does not apply to the extent it is less favourable than the views in the Ruling, where the first CGT event happens to an exchanging member before the date of issue of this Addendum.

Commissioner of Taxation
20 April 2005

ATO references
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