The Tax Summit

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1. Franked Distributions Funded by Capital Raisings

Last month, on 14 September 2022, the Government published Exposure Draft Legislation which proposes a new integrity measure that would treat certain distributions made by an entity as unfrankable where they are directly or indirectly funded by a capital raising.[1] The integrity measure would, if enacted, apply retrospectively to distributions on or after 19 December 2016.

The Exposure Draft Legislation came as an unwelcome surprise to taxpayers and their advisors: it has been almost six years since the Government originally announced its intention to introduce the measure as part of the 2016-17 Mid-Year Economic and Fiscal Outlook (***MYEFO Announcement***) and more than seven years since the ATO published Taxpayer Alert TA 2015/2 (the ***Taxpayer Alert***), which identified the particular dividend and capital-raising arrangements of concern. Given the lapse of time, most people assumed that the measure would continue to languish, in legislative limbo, as one of the many announced but unenacted tax measures.[2] That assumption was especially justified since the practice that seemed to be the main target of the measure – equity-funded special dividends – has largely ceased.

The MYEFO Announcement and the Taxpayer Alert were relatively modest in scope: they address an arrangement where, in essence, a company pays a non-routine, and possibly 'unusually large', fully franked dividend, and to fund the dividend payment, undertakes a capital raising at a similar time and in a similar amount. The effect of the arrangement is that the company's cash flow is unaffected, its net assets remain the same, and there is a minimal impact on shareholders. The apparent mischief is that the arrangement has no real purpose or effect other than to allow the shareholders to receive franking credits.

The proposed new measure is anything but modest in scope. On the contrary, we read it to create an integrity rule of alarming breadth. It makes non-routine distributions unfrankable where, in substance, there is an issue of equity interests (by that entity or another entity) and either the *principal effect* of the issue is to directly or indirectly fund all or part of the distribution *or* the entity (or any entity that facilitated the issue) did so for a *non-incidental purpose* of funding all or part of the distribution. By incorporating a principal effect or non-incidental purpose test, the proposed measure may apply to ordinary capital raising activities that are conducted before or after any non-routine distribution, including where the capital raising is conducted by an entity that is unrelated to the entity that makes the distribution. It therefore covers, on its face, a host of arrangements that were not covered by the MYEFO Announcement or the preceding Taxpayer Alert; its retrospectivity is, therefore, especially inappropriate.

To make matters worse, the measure applies *automatically*. Unlike section 177EA of the *Income Tax Assessment Act 1936* (Cth) (***1936 Act***), it is not predicated on the Commissioner making a determination and therefore it requires taxpayers to self-assess their compliance and does not allow the Commissioner to choose to debit a company's franking account, rather than deny shareholders franking credits. And its effect is severe: it prevents the *entire* distribution from being frankable, even where it is only partially funded by the equity issuance.

The measure also lacks a coherent policy rationale: it would apply to non-routine distributions which are funded by new capital raisings, but would not (or may not) apply to distributions that are funded out of a company's existing cash reserves or new third party (or related party) debt. Nor would it apply to regular or routine distributions that are funded by capital raisings. Neither Treasury nor the ATO has articulated a compelling reason why different sources of funding, or the status of the distribution as a routine or non-routine distribution, should, of themselves, affect the distribution's frankability. In its current form, therefore, we fear the measure is liable to produce distortionary effects on an entity's funding activities by providing a disincentive for equity funding and

[1] Exposure Draft, *Treasury Laws Amendment (Measures for a later sitting) Bill 2022* (Cth).

[2] As discussed below, the ATO was evidently more optimistic: 2020 Class Ruling for the Zenith Energy Limited Scheme of Arrangement and Special Dividend foreshadowed the potential operation of the proposed integrity measure (see Section 1.5).

otherwise to discourage entities from making out-of-cycle distributions, which might disproportionately burden entities that do not make regular distributions, such as private entities or start-ups.

We are not alone in our criticisms. In the three-week window the Government allowed consultation on the proposed measure, many different industry bodies, law firms, accounting firms and other advisors made submissions heavily criticising the proposed measure. We are hopeful the Government will heed those concerns.

1.1 The Taxpayer Alert

1.1.1 Overview

On 7 May 2015, the ATO issued the Taxpayer Alert which stated that it was reviewing arrangements with all or most of the following features:

- A company with a significant franking credit balance raises new capital from existing or new shareholders, including, for example, through issuing renounceable rights to shareholders. Shareholders may include large institutional superannuation funds.

- At a similar time to the capital raising, the company makes franked distributions in a similar amount to the amount of capital raised, including, for example, by paying a special dividend or undertaking an off-market buy-back (where part of the buy-back price would be treated as a 'frankable distribution').

- Overall, (A) there is minimal net cash inflow to or outflow from the company; (B) the net asset position of the company remains essentially unchanged but their franking account is significantly reduced, and (C) there is minimal impact on the shareholders, except in some cases they may receive refunds of franking credits, and in the case of buy-backs they may also get improved capital gains tax outcomes.

- The franked distributions may be unusually large compared to ordinary dividends previously declared and paid by the company.

- The franked distribution may be receivable by all existing shareholders of the company, or in the case of a share buy-back, shareholders may have a choice whether or not to participate.

The Taxpayer Alert articulates a concern that companies undertake such arrangements for the purpose of, or for purposes which include, releasing franking credits or streaming dividends to shareholders that the companies would otherwise retain. The ATO suggests that such arrangements might attract the operation of the anti-avoidance rule in section 177EA of the 1936 Act or other anti-avoidance rules, but offers no analysis in support of those statements.

1.1.2 Background: transactions leading to the Taxpayer Alert

The background to the Taxpayer Alert provides important context for understanding the origins of the proposed new integrity measure. Around the time of the Taxpayer Alert, it appears that there was a broader ATO focus on franking-related mischief; the Taxpayer Alert was published shortly after another Taxpayer Alert which was similarly focused on potential misuse of the dividend imputation rules: TA 2015/1 *Dividend stripping arrangements involving the transfer of private company shares to a self-managed superannuation fund*. More notably, the Taxpayer Alert appears to have been prompted by a series of underwritten dividend reinvestment plans and rights issues which were undertaken by certain listed companies in connection with the payment of fully franked special dividends.

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Dividend reinvestment plans and rights issues (also known as entitlements issues) are two means by which existing shareholders are commonly invited to subscribe for new share capital. The company is not certain to raise the full amount it is targeting from existing shareholders, some of whom may decline the invitation in whole or part, unless the arrangement is the subject of an underwriting commitment. An underwriting commitment involves a third party (usually a financial institution), who agrees, in return for an underwriting fee, to subscribe, or to procure the subscription, for those shares which the existing shareholders either choose not to subscribe for or who are ineligible, for regulatory reasons, to subscribe for (e.g. because of foreign residence).

The three most relevant examples preceding the publication of the Taxpayer Alert are considered below. Importantly, each involved an arrangement where the persons who subscribed for shares under the plans or participated in the rights issues were *not* eligible for the special dividend.

1.1.2.1 Vita Group

On 24 October 2014, Vita Group Limited (***Vita Group***) announced plans to pay a fully franked special dividend of 3 cents per share. The Company announced that its Dividend Reinvestment Plan would be available to shareholders who chose to reinvest the special dividend in shares, and that, under the plan, shareholders could elect to apply the special dividend payable to them to subscribe for new shares in Vita Group at a discounted subscription price. The DRP would be fully underwritten by Cannacord Genuity (Australia) Limited. The dividend would be paid to all eligible shareholders on the register on the record date of 10 November 2014. The special dividend would be paid – or new shares issued to DRP participants – on 5 December 2014. The new shares issued to DRP participants would not be eligible for the special dividend.

On 25 February 2015, in Class Ruling CR 2015/17, the Commissioner confirmed that:

- the special dividend paid by Vita Group could be fully franked in accordance with Division 202 of the *Income Tax Assessment Act 1997* (Cth) (***1997 Act***);
- no determination would be made under the anti-streaming provisions (subsection 204-30(3)(c)) to deny the imputation benefit received by Vita Group shareholders in relation to the special dividend; and
- similarly no determination would be made under section 177EA to deny the imputation benefit received by Vita Group shareholders in relation to the special dividend – broadly, this was on the basis that the Commissioner did not think that the scheme was being entered into by Vita Group or the Vita Group shareholders for more than an incidental purpose of enabling participating shareholders to obtain imputation benefits (see paragraph 115). Among other things, the Commissioner noted that the special dividend would be paid to the existing shareholders of Vita Group in proportion to their shareholding, and irrespective of their ability to utilise the relevant franking credits.

On 8 July 2015 – less than 6 months after its publication – the Commissioner withdrew the Class Ruling. In the Notice of Withdrawal, the Commissioner noted that the reason for withdrawal was that the term of the Class Ruling had finished, but also that its subject matter was subject to review as a result of the Taxpayer Alert, which had been published two months earlier.

1.1.2.2 Tabcorp and Harvey Norman

Around the same time as the Vita Group transaction, Harvey Norman Holdings Limited (***Harvey Norman***) and Tabcorp Holdings Limited (***Tabcorp***) undertook a broadly similar transaction except that the new capital was raised by an underwritten 'renounceable entitlement offer' (also known as a 'rights issue'):

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- On 25 November 2014, Harvey Norman announced its intention to pay a full franked special dividend of 14 cents per share and, on the same date, announced a fully underwritten pro-rata renounceable entitlement offer of new Harvey Norman ordinary shares. Under that offer, Harvey Norman shareholders were invited to subscribe (at a discounted price) for one ordinary share in Harvey Norman for every 22 existing Harvey Norman ordinary shares they held. In its announcement, Harvey Norman noted that "the proceeds [from the entitlement offer] will be used to fund the payment of a special fully franked dividend to shareholders." The new shares would not be entitled to the special dividend.[3]

- On 5 February 2015, Tabcorp announced a fully franked special dividend of 30c per share and, at the same time, also announced a capital raising by way of a fully underwritten pro rata accelerated renounceable entitlement offer. The total value of the fully franked special dividend was approximately $230 million, while the total value intended to be raised under the renounceable entitlement offer was approximately $236 million. The announcement noted that the special dividend was to be paid out of retained earnings, with the entitlement offer being run to maintain Tabcorp's balance sheet and capital position. Under the offer, shareholders were entitled to purchase (at a discount) one share for every 12 shares owned. The new shares issued under the offer were unable to participate in the special and interim dividend.[4]

There does not appear to be any public record of either company engaging with the ATO about the arrangements.

1.1.3 Discussion of Taxpayer Alert

The arrangements covered by the Taxpayer Alert were confined to arrangements that had many or all of the features described above. Recall again that the covered arrangement essentially involves (1) a capital raising at a similar time and of a similar amount to the fully franked distribution; (2) no real effect on the company's cash flow or financial position; (3) no real impact on shareholders, other than tax refunds as result of the franking credits; and (4) an out-of-cycle distribution which might be 'unusually large' compared to previous distributions. For that narrow class of arrangements, it is apparent that the Commissioner viewed the payment of a dividend funded by a new capital raising under such arrangements as having little or no purpose or effect other than to release, inappropriately, a franking credit benefit to shareholders. As we explain below, the proposed new measure addresses a significantly broader class of arrangements than the arrangements covered by the Taxpayer Alert.

Despite the narrowness of the arrangements contemplated by the Taxpayer Alert, it is worth pausing to consider a couple of their features. As explained above, one of the features of the covered arrangements is that 'there is minimal impact on the shareholders, except in some cases they may receive refunds of franking credits, and in the case of buy-backs they may also get improved capital gains tax outcomes'. That statement is evidently based on two assumptions, neither of which is necessarily correct. The first is that the shareholder would subscribe an amount equal to the cash amount of the dividend for new share capital. But in the Vita Group, Harvey Norman and Tabcorp examples discussed above, the percentages of shareholders receiving the special dividend who elected to subscribe for new shares varied widely.[5]

The second assumption is that the shareholders would have a marginal tax rate of less than 30% (such as complying super funds). But in most cases involving listed companies, that is unlikely to be an accurate statement of the position for all shareholders. The percentage of such shareholders will vary according to the particular

[3] The special dividend was paid on 30 December 2014. The fully underwritten pro-rata renounceable entitlement offer completed on 22 December 2014.
[4] The special dividend was paid on 16 March 2015. The institutional component of the pro-rata accelerated renounceable entitlement offer completed on 10 February 2015 and the retail component completed on 6 March 2015.
[5] See L Magid, 'Capital management' (presented at the 2016 National Resources Tax Conference) dated 26 October 2016.

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company. In such cases, there will obviously be shareholders whose marginal tax rate exceeds 30%. Those shareholders will pay additional tax as a result of the special dividend.

Another feature is that 'the net asset position of the company remains essentially unchanged…but their franking account is significantly reduced'. But the Taxpayer Alert does not mention that the arrangements *do* result in a depletion of the company's retained earnings or profits and an increase in its paid up share capital. Nor does the Taxpayer Alert explain why the distribution of taxed profits in other circumstances when there is no change to the company's net asset position (e.g. as a result of a third party borrowing) is not similarly problematic.

1.2 2016-2017 MYEFO Announcement

The introduction of the new integrity measure was first announced by then-Treasurer Scott Morrison as part of the 2016-17 Mid-Year Economic and Fiscal Outlook.[6] In particular, the expressed policy objective of the measure was described by the Government as follows:

> *The Government will introduce a specific measure preventing the distribution of franking credits where a distribution to shareholders is funded by particular capital raising activities.*
>
> *The measure will apply to distributions declared by a company to its shareholders outside or additional to the company's normal dividend cycle (a special dividend), to the extent it is funded directly or indirectly by capital raising activities which result in the issue of new equity interests. Examples of capital raising activities include an underwritten dividend reinvestment plan, a placement or an underwritten rights issue.*
>
> *Where such arrangements are entered into, the corporation will be prevented from attaching franking credits to shareholder distributions.*
>
> *This measure will address the issues raised by the Australian Taxation Office in Taxpayer Alert TA 2015/2: Franked distributions funded by raising capital to release credits to shareholders.*
>
> *This measure will apply to distributions made after 12:00pm (AEDT) on 19 December 2016. It is estimated to have a gain to revenue of $30.0 million over the forward estimates period.*

There are three notable features of the MYEFO Announcement:

- First, according to the MYEFO Announcement, the measure was intended to apply to distributions 'declared' by a 'company' to its shareholders (a 'special dividend'). The measure proposed by the Exposure Draft Legislation, in contrast, would apply to any 'franked distributions', which would include, for example, distributions that may not necessarily be 'declared' (as ordinarily understood) by a company but deemed to be made by the company for tax purposes. This would include, for example, the deemed 'dividend component' of an off-market share buy-back.[7] It also applies to entities that are not companies.

- Second, the MYEFO Announcement was expressly designed to address the issues in the Taxpayer Alert. As explained below, the text of the proposed new measure applies far more broadly.

- Third, the MYEFO Announcement stated that the new measure would apply to distributions by a company "**to the extent** it is funded directly or indirectly by capital raising activities which result in the issue of new equity interests (emphasis added)." Under the new integrity measure, if *any* part of the distribution is directly or indirectly funded by a capital raising, the entire distribution would be treated as 'unfrankable'.

[6] Commonwealth of Australia, 2016-17 Mid-Year Economic and Fiscal Outlook, 112-113.

[7] We discuss this in the context of the hypothetical examples below.

1.3 Aftermath

As explained above, we understand the practice of companies funding special dividends from equity raisings has largely ceased. In its 2021 Reportable Tax Positions Schedule Findings Report concerning disclosures required for TA 2015/2, the ATO said they had:

> continued to monitor the risk associated with arrangements described in Taxpayer Alert TA 2015/2. Our risk identification processes, and assurance programs have confirmed these arrangements are no longer prevalent in the large public and multinational business population. This gives us confidence we don't have a non-disclosure risk.

1.4 Do we need a specific integrity rule?

As noted above, in the Taxpayer Alert the ATO states that arrangements which fall within its scope may attract the operation of the anti-avoidance rule in section 177EA of the 1936 Act. The proposed introduction of the new integrity rule suggests, however, that there are – or, at least, are perceived to be – deficiencies in the existing suite of tax integrity rules, including section 177EA. We consider below whether section 177EA is deficient. Separately, in our view, a special dividend that is paid out of retained earnings or profits is not sourced directly or indirectly from a share capital account – and therefore is not unfrankable under section 202-45(e) of the 1997 Act – merely where it is funded out of a capital raising.[8]

Where a special dividend paid to shareholders is funded by capital raised by the issue of new shares, but the new shares are *not* entitled to receive the special dividend (as in each of the three examples considered above, Vita Group, Harvey Norman and Tabcorp), there is a strong argument that section 177EA cannot apply to deny the imputation benefits flowing from the special dividend. In order for section 177EA to apply, subsection 177EA(3) requires that:

(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 the 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.

Paragraph (b) requires that a frankable distribution be paid 'in respect of the membership interests' – that is, the membership interests that are referred to in paragraph (a). Those membership interests are membership interests in respect of which there is a scheme for a disposition. The issue of new shares as a means to fund payment of a special dividend is clearly 'a scheme for a disposition of membership interests' and therefore section 177EA is

[8] For a more detailed discussion of the reasons supporting this conclusion, see L Magid, 'Capital management' (presented at the 2016 National Resources Tax Conference) dated 26 October 2016.

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capable of applying to franked distributions payable on the new membership interests. But, as explained above, in the Vita Group, Harvey Norman and Tabcorp examples, no special dividends were payable in respect of the new shares. Franked dividends were only payable on the existing shares and since the payment of a dividend on a share does not itself involve a 'scheme for a disposition of' that membership interest, we consider that section 177EA could not apply to the special dividends paid on the existing shares.[9]

This same argument would not be available where a franked distribution is effected by way of a selective off-market share buy-back. For the purposes of section 177EA, an off-market share buy-back would involve the 'disposition of membership interests' (namely, the shares bought back by the company) in respect of which a 'frankable distribution' would, for tax purposes, be taken to be payable under Division 16K of the 1936 Act. The franked distribution would, broadly, equal the amount by which the buy-back price exceeds the portion of it which is debited against amounts standing to the credit of the company's share capital account. In the context of an off-market share buy-back, therefore, it may be open to the Commissioner to make a determination under section 177EA denying the imputation benefit for a shareholder in respect of the dividend component of the share buy-back price (or determine that a franking debit arises in the company's franking account in respect of the distribution), provided that the Commissioner is able to establish, having regard to the relevant circumstances of the scheme (see section 177EA(17)) that, broadly, there was a requisite non-incidental purpose of enabling the relevant taxpayer to obtain an imputation benefit. Whether or not that necessary conclusion could or would be reached would depend upon the relevant circumstances (subsection 177EA(17)) of the particular scheme. If the same shareholder whose shares were bought back subscribed for new shares in the same company at around the same time, that might support the inference of a relevant purpose. If not, inferring a relevant purpose is likely to be more difficult. As a matter of principle, if the franking credits are being released through a genuine distribution of actual profits, it should make no difference whether that distribution is funded out of the company's existing cash resources, new borrowings or new issues of share capital.

Although section 177EA may be available in off-market share buy-back contexts, we expect that the Commissioner would nevertheless be more likely to rely primarily on the proposed new integrity rule because, as currently formulated, it applies where the 'principal effect' of the issue of equity interests is to fund any part of the distribution, without requiring any showing of purpose. In addition, the requisite purposes required by section 177EA and the new integrity rule are different: section 177EA requires a non-incidental purpose of enabling a taxpayer to obtain an imputation benefit (franked dividends), and the new integrity rule requires a non-incidental purpose that the capital raising was to fund any part of the relevant distribution.

1.5 Zenith Energy – Scheme of Arrangement and Special Dividend

After the MYEFO Announcement, but before the release of the Exposure Draft legislation, in at least one scheme of arrangement involving the payment of a special dividend by a target company the Commissioner has already foreshadowed the possibility of applying the new integrity rule. In July 2020, Zenith Energy Limited (***Zenith Energy***) announced that it had entered into a Scheme Implementation Deed with BidCo. BidCo was owned by a consortium of funds managed by PEP, OP Trust and Apex Opportunities Trust. BidCo proposed to acquire all the issued shares of Zenith by way of a scheme of arrangement under Part 5.1 of the *Corporations Act 2001* (Cth) for cash consideration of $1.05 per Zenith share (less the amount of the Special Dividend, if declared and paid). On 7 April 2020, Zenith announced its intention to declare a Special Dividend of 13 cents per Zenith share (subsequently increased to 14 cents per Zenith share) which would be fully franked and payable to Zenith shareholders who held their shares at 12 August 2020 (the Special Dividend Record Date). The Special Dividend was funded by a loan from BidCo to Zenith.

In Class Ruling CR 2020/52, the Commissioner ruled that (among other things):

[9] Section 177EA is capable of applying to other distributions that are expected to be payable in respect of the shares.

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- the Special Dividend was a 'frankable distribution' pursuant to section 202-40, and that resident shareholders would be required to include the dividend (and the franking credits attached to the dividend) in their assessable income, but should be entitled to a tax offset equal to the amount of those credits provided they are a 'qualified person';

- the Commissioner would not make a determination under section 177EA (or section 204-30) to deny the imputation benefit received in relation to the Special Dividend – in relation to section 177EA, this was on the basis that the Commissioner could not conclude that Zenith or Zenith shareholders entered into or carried out the scheme for the purpose of enabling the Zenith shareholders to obtain an imputation benefit; and

- the capital proceeds from the disposal of each Zenith share would include the Special Dividend.

Notably, the Commissioner qualified the Class Ruling with a cautionary note which referred to the MYEFO Announcement and the Taxpayer Alert:

> *Important note - announced but unenacted legislation*
>
> 7. This Ruling only applies based on the law as at the date of publication of the Ruling.
>
> 8. In the Mid-Year Economic and Fiscal Outlook 2016-17, the Government announced that it would introduce a specific measure to prevent a company from attaching franking credits to distributions to shareholders made outside or additional to the company's normal dividend cycle, to the extent the distributions are funded directly or indirectly by capital raising activities that result in the issue of new equity interests.
>
> 9. This measure is intended to address issues raised by the ATO in Taxpayer Alert TA 2015/2 *Franked distributions funded by raising capital to release franking credits to shareholders.* This measure, if enacted, will apply to distributions made after midday AEDT on 19 December 2016.
>
> 10. As at the date of publication of this Ruling, legislation to implement the Government's announced intention remains unenacted. If a provision in respect of which this Ruling is made is amended with retrospective effect, or is affected by another provision enacted with retrospective effect, some of the conclusions reached in this Ruling may be incorrect. Accordingly, the Commissioner provides this Ruling on the basis that it applies only to the current law in its current context. In the event legislation to implement the Government's announced intention does apply to any aspect of the Scheme of Arrangement and Special Dividend described in this Ruling, some of the conclusions in this Ruling may not be able to be relied upon. In such circumstances, the Commissioner may issue an addendum to this Ruling with retrospective effect.

The Class Ruling does not contain any discussion about the particular features of the Zenith scheme of arrangement and special dividend payment which were thought to implicate any new integrity rule. The most obvious aspect of the arrangement which may have caused the Commissioner to include a statement to that effect relates to the loan advanced by BidCo to Zenith to fund the special dividend, which, as explained below, may have borne characteristics of an equity interest.

Clause 4.9 of the Amended and Restated Scheme Implementation Deed provided that:

> "(a) Bidder agrees that, if Target decides to pay and pays a Permitted Dividend in accordance with clause 4.8(a), Bidder will, subject to the Scheme having become Effective, provide an **unsecured, interest free loan** to Target in an amount equal to the aggregate cash amount of the Permitted Dividend, that is subordinated to the Target's existing debt facilities.
>
> (b) The loan provided pursuant to clause 4.9(a) must be paid by Bidder to Target at least one Business Day prior to the payment date for the Permitted Dividend."

Since the publication of the Taxpayer Alert (and the MYEFO Announcement), there have been several other schemes of arrangement which have similarly involved the payment by the target of a special dividend which has been funded by the purchaser. For example, under each of the 2019 schemes of arrangement involving Legend

Corporation Limited and AIRR Holdings Limited, the purchaser advanced the target an interest-free loan to fund the payment of a special dividend to target shareholders. The Commissioner issued a Class Ruling for each scheme (CR 2019/56 and CR 2019/74), but neither class ruling included a qualification of the type the Commissioner included in the Zenith Class Ruling.

One important potential point of difference between those other schemes and the Zenith scheme may have been that the loan provided by BidCo to Zenith could, at the discretion of the lender, be converted, exchanged or otherwise repaid wholly or partly by way of the issue of shares: see paragraph [67] of CR 2020/52. In particular, the Commissioner may have formed the view that the terms of the Zenith loan (in contrast to the loans provided to Legend Corporation Limited and AIRR Holdings Limited) may have been be an 'equity interest' (rather than 'debt interest') for tax purposes (or that it would later be converted to an equity interest), and therefore, in the nature of a 'capital raising' for purposes of the MYEFO Announcement. As explained in more detail below, one of the threshold conditions of the new integrity rule is that there is an issue of 'equity interests' in the company or any other entity – this could include, for example, legal-form debt that is an equity interest for tax purposes.

1.6 The new integrity rule proposed by the Exposure Draft Legislation

1.6.1 Key threshold conditions

Under the Exposure Draft Legislation, a new provision (section 207-159) would be introduced into the 1997 Act. A distribution to which new subsection 207-159(1) applies would be 'unfrankable' under section 202-45. The threshold conditions for new subsection 207-159(1) are outlined below:

	Threshold Conditions	Description
Pattern of distributions	The distribution is not consistent with an **established practice** of the entity of making distributions of the kind on a 'regular basis'	• As a preliminary matter, the new measure would apply to any 'distribution', which is defined in section 960-120 (for a company) to mean a 'dividend' or 'something that is taken to be a dividend' for the purposes of the 1997 Act. This would include, for example, the 'dividend component' of an off-market share buy-back (see 159GZZZP of the 1936 Act). • Broadly, this condition is designed to ensure that the integrity rule does not affect 'ordinary distributions' that have been made on a regular basis and are not made as part of 'artificial arrangements' designed to distribute franking credits to shareholders (para 1.24 of the Explanatory Materials). • This condition applies either where a distribution 'of a kind' is inconsistent with an entity's established practice, or where the entity does not have an established practice. The meaning of the phrase 'of a kind' is not clear. • In determining whether an established practice exists, it is necessary to consider, among other things, the nature, timing and amount of past distributions, explanations given by the entity for making such distributions, as well as the franking credits attached to and the extent to which past distributions are franked (subsection 207-159(2)). For example, if an entity has paid a dividend of the same amount to the same class of shareholders at the same time each year for many years, the entity would have a practice of making such distributions. • For these purposes, the rules disregard any distribution which is a franked distribution (or would be a franked distribution but for the new integrity rule) where that distribution is funded directly or

	Threshold Conditions	Description
		indirectly by a capital raising – in other words, if, disregarding the first threshold condition, the integrity rule would apply to treat the distribution as 'unfrankable', that distribution must be disregarded when determining whether an established practice exists. • Where a company has an established practice of declaring and paying dividends, this condition is not satisfied and, subject to other integrity rules, a company is permitted to fund (and frank) a dividend by raising capital. The integrity rule condition would therefore appear to disadvantage companies who, for various non-tax reasons, do not make regular distributions, such as privately held or newly established businesses (eg, start-ups). In contrast, ordinary dividends paid by listed companies are likely not to be covered by this condition. But even in the case of companies that pay regular interim and financial dividends, the integrity rule applies to particular types of distributions that naturally happen less frequently, such as deemed dividends under buy-back transactions and special dividends. • More broadly, it is difficult to reconcile the underlying policy rationale of, on the one hand, permitting a regular distribution to be franked where it is funded by a capital raising, while on the other denying franking credits on distributions which are paid in connection with a (genuine) significant transactional event (eg, a sale of a significant asset or business of the company where the purchaser funds the purchase price by an equity raising) or simply because it is the first time the company has made a profit. The Government has not offered any policy rationale for distinguishing these scenarios.
The issue of 'equity interests'	There is an **issue of 'equity interests'** in the company or another entity (whether before, at or after the time at which the distribution was made)	• According to the Explanatory Materials, this is a deliberately broad requirement. In particular, for the purposes of this condition, the equity interests may be issued (1) by the company making the distribution *or another entity* (whether that entity is a company, trust or partnership), and (2) *before, at or after* the time at which the distribution is made. There is no requirement that the entity issuing the equity interest be related (e.g. an associate) to the entity paying the special dividend, nor is there any requirement of temporal proximity between the issue and the payment. • An 'equity interest' in an entity picks up the existing definition under section 995-1(1), however, section 820-930 would be amended so that the modifications that apply to trusts and partnerships would extend to this new integrity rule. • As noted above, this condition appears to be much broader than the original MYEFO announcement which stated that the measure would address the issues raised in the Taxpayer Alert, which focused on a scenario where the company that paid the franked dividend and issued shares was the same company.
The principal effect or purpose test	It is reasonable to conclude, having regard to all relevant circumstances, that: • the **principal effect** of the issue of any of the equity	• This is the key requirement testing the nexus between the capital raised by the issue of the equity interests and the funding of the distribution. It introduces an alternative test: principal effect or non-incidental purpose.

	Threshold Conditions	Description
	interests was the direct or indirect funding of the relevant distribution; or • an entity that issued, or facilitated the issue of, any of the equity interests did so for a **purpose** (**other than an incidental purpose**) of funding the relevant distribution or part of the distribution.	• The 'principal effect' limb is based on the existing test under Division 165 of the GST Act,[10] while the 'purpose' test is based on section 177EA of the 1936 Act (paragraph 1.29 of the Explanatory Materials). The Explanatory Materials suggest that in many cases the outcome of the 'purpose' limb and the 'principal effect' limb would be expected to be the same, and that the inclusion of both limbs serves to ensure that the provision applies where either the intention or effect of a capital raising is to fund a distribution – for example, it could apply where an entity seeks to combine a distribution funded by a capital raising with an ordinary dividend which is paid on a regular basis by the company (and therefore, would not implicate the integrity rule), or where the issue of equity interests is to fund the distribution but also raise capital for genuine commercial or regulatory purposes. • Proposed subsection 207-159(4) sets out a list of matters required to be taken into account when establishing the requisite principal effect or purpose. Notably, this includes (A) the use of the funds raised – even if, for example, the new funds raised are quarantined and used for a specific purpose but it serves to free other funds to be distributed that would otherwise be used for that purpose, that may be indicative of funds being raised for the distribution; and (B) the extent to which the fund raising is 'underwritten' – according to the explanatory materials, this would be an important indication of whether the capital raised is guaranteed which may inform its purpose or effect.

1.6.2 Potential scope of the new integrity rule

As explained above, we read the proposed new measure to create an integrity rule of alarming breadth. Part of the difficulty in understanding the intended scope of the proposed rule is that the Explanatory Materials offers no examples. We have therefore designed some hypothetical examples to explore its potential breadth. The examples involve a hypothetical taxpayer, 'Waystar', with the following background facts:

- Waystar, run by an eccentric and ruthless patriarch (and octogenarian), is an ASX-listed public company.
- Waystar's new streaming platform – **StarFlix** – is a hit, and business has been booming.
- Waystar has consistently announced and paid two full franked dividends each year – an interim dividend announced around the time of half-year results, and a full year dividend announced around the time of full year results.
- Waystar announces its full year dividend for the financial year ended 30 June 2022 and completes payment of the dividend in July 2022.
- Waystar has a significant franking account balance. It also has sufficient current year profits from which to appropriate and pay any dividend.

[10] There is limited authority considering Division 165, but see *Re Taxpayer and Federal Commissioner of Taxation* (2010) 76 ATR 917.

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1.6.2.1 Scenario 1 – Special dividend funded by underwritten rights issue

- Waystar announces a special dividend and a capital raising by way of a fully-underwritten renounceable entitlement offer on 22 August 2022; the capital raising target is for the total amount of the special dividend.
- Waystar completes the capital raising prior to the special dividend payment date on 3 October 2022, raising the full amount of the target amount.
- Waystar pays the special dividend to shareholders on 10 October 2022.

Potential application of proposed new integrity rule

- There is a significant risk that the special dividend is **unfrankable** on the basis that: (1) the special dividend would be an out-of-cycle distribution; (2) the renounceable entitlement offer would involve the issue of equity interests in Waystar; and (3) the principal effect of undertaking the capital raising would likely be to fund the payment of the special dividend. In considering the principal effect, it is relevant (and presumably, helpful to the Commissioner) that the equity issue was underwritten (section 207-159(4)(f)); that the amount of the capital raising matches the amount of the special dividend (section 207-159(4)(b)); and that Waystar's financial position is substantially unchanged (section 207-159(4)(c)). If the principal effect test is satisfied, it not necessary to consider the purpose test.

1.6.2.2 Scenario 2 – Waystar invests into RoyCo, pays ordinary dividend

- RoyCo, a start-up company, has been developing a streaming service with a twist: using virtual reality.
- After three years of successfully operating the business, RoyCo announces its intention to pay an ordinary dividend (its first) to the founders.
- Two months earlier, Waystar and Sandy and Stewy (Waystar's competitors and occasional collaborators) had subscribed for new shares (which do not entitle them to receive the ordinary dividend).

Potential application of proposed new integrity rule

- There is a risk that the ordinary dividend is **unfrankable** on the basis that: (1) it would be an out-of-cycle distribution because RoyCo would not be able to establish a practice of paying ordinary dividends (it is a start-up); (2) Waystar, Sandy and Stewy have recently subscribed for new shares; and (3) the principal effect of issuing the equity interests in RoyCo to Waystar, Sandy and Stewy would be to, indirectly, fund part of the payment of the ordinary dividend.

1.6.2.3 Scenario 3 – Scheme of arrangement + special dividend

- On 22 August 2022, Waystar signs a scheme implementation deed (***SID***) with GoJo. Under the terms of the SID, Waystar is permitted to pay a fully franked special dividend prior to implementation of the scheme.
- On 27 September 2022, the Waystar board determines to pay a fully franked special dividend contingent on the scheme of arrangement becoming effective.
- On 24 November 2022, Waystar pays the fully franked special dividend to shareholders. The special dividend is funded entirely from existing cash reserves and working capital of Waystar.

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- On 1 December 2022, the scheme of arrangement completes.

Potential application of proposed new integrity rule

- The special dividend should be **frankable** on the basis that the special dividend would be an out-of-cycle distribution but the dividend would be sourced entirely from existing cash reserves and working capital of Waystar so would not involve the issue of equity interests in the company (or any other entity).

1.6.2.4 **Scenario 3A – Special Dividend Funded by GoJo loan**

Additional Facts

- Under the terms of the SID, GoJo agrees to fund the special dividend with an interest free loan (repayable within 5 years). GoJo sources the funds for the loan from existing cash reserves and third party debt.

Potential application of proposed new integrity rule

- The special dividend should be **frankable** on the basis that the funding for the special dividend would be sourced entirely from the interest-free loan provided by GoJo and would not involve the issue of equity interests in the company (or any other entity).

1.6.2.5 **Scenario 3B – Special Dividend Funded by GoJo loan (capitalising GoJo)**

Additional Facts

- Under the terms of the SID, GoJo agrees to fund the special dividend with an interest free loan (repayable within 5 years). GoJo sources the funds for the loan through the Matsson Family (the majority owners of GoJo) capitalising GoJo with new equity.

Potential application of proposed new integrity rule:

- There is a significant risk that the special dividend is **unfrankable** on the basis that: (1) the special dividend would be an out-of-cycle distribution; (2) the capitalisation of GoJo would involve the issue of equity interests in GoJo to the Matsson Family; and (3) the principal effect (or non-incidental purpose) of undertaking the issue of the equity interests would likely be to – indirectly, through the interest free loan provided by GoJo – fund the payment of the special dividend.

1.6.2.6 **Scenario 3C – Special Dividend Funded by GoJo loan (convertible)**

Additional Facts

- Under the terms of the SID, GoJo agrees to fund the special dividend with an interest free loan (repayable within 5 years). The terms of the interest free loan provide that it is convertible to shares in Waystar at the election of Waystar.

Potential application of proposed new integrity rule:

- There is a significant risk that the special dividend is **unfrankable** on the basis that: (1) the special dividend would be an out-of-cycle distribution; (2) the provision of an interest free loan by GoJo which is convertible at the election of Waystar would likely constitute the issue of a (non-share) equity interest by Waystar (ie, legal form debt but treated as equity for tax purposes on the basis that the loan is convertible

into shares at the election of Waystar[11]); and (3) the principal effect (or non-incidental purpose) of the interest free loan (ie, the issue of the equity interest by Waystar) would be to fund the payment of the special dividend.

1.6.2.7 Scenario 4 – Off-Market Share Buy-Back paid on Sale of Asset

- After a big push by the founder (who is keen to stick to more proven, traditional, forms of media), Waystar agrees to the sale of its prized asset – StarFlix – to GoJo.
- GoJo funded the purchase price of StarFlix by a combination of existing cash reserves, third party debt, and by undertaking a capital raising by way of a fully-underwritten renounceable entitlement offer on 5 September 2022.
- Waystar announces an off-market buy-back to return proceeds from the sale of StarFlix on 24 October 2022.
- Under the terms of the buy-back, part of the share buy-back price will be debited to an amount standing to the credit of Waystar's share capital account, with the balance deemed to be a dividend paid out of profits for tax purposes.
- Waystar completes the off-market buy-back on 28 November 2022.

Potential application of proposed new integrity rule

- There is a significant risk that the special dividend is **unfrankable** on the basis that: (1) the dividend component of the share buy-back would be taken to be an out-of-cycle distribution; (2) the capital raising undertaken by GoJo would involve the issue of equity interests in GoJo; and (3) there is a good argument that the principal effect (or non-incidental purpose) of the issue of the equity interests by GoJo would be to – indirectly, through partially funding the purchase price paid for the asset – fund part of the share buy-back price paid by Waystar to undertake the buy-back.
- The same analysis is likely to apply if the proceeds from the sale of the asset were returned to Waystar shareholders through a mixture of a special dividend and capital return.[12]

1.6.3 The consequences of the new integrity rule applying

As noted above, a distribution to which new subsection 207-159(1) applies would be 'unfrankable' under section 202-45. This consequence follows even where the issue of equity interests only funded a *part* of the distribution. Shareholders who receive distributions to which subsection 207-159(1) applies would therefore not be entitled to a tax offset and the amount of any franking credit attaching to the distribution would not be included in the assessable income of the shareholder. Moreover, the distribution would not be exempt from dividend withholding tax under section 128B(3)(ga) of the 1936 Act.

Unlike some of the existing franking credit tax integrity rules – for example, section 177EA of the 1936 Act and section 204-30 of the 1997 Act – the application of new subsection 207-159(1) is not predicated on the Commissioner making a determination. In other words, taxpayers would be required to self-assess its application.

[11] Item 4 of section 974-75(1) and section 974-130 1997 Act. See also, PBR: 1011956955706.
[12] See, for example, the special dividend/capital return transactions undertaken by PRT Company Limited (formerly known as Prime Media Group Limited) (Class Ruling CR 2022/57) and Amaysim Australia Limited (Class Ruling CR 2021/40) following major asset disposals.

These design features mean that, unlike those other integrity rules, the sole consequence of a distribution which is taken to be funded by a capital raising is that the distribution is treated as unfrankable in the hands of the recipient. That is, there is no scope for the Commissioner to choose to make a determination that a franking debit should instead arise in the franking account of the company in connection with the distribution.

If a company makes a distribution which the new integrity rule treats as an 'unfrankable' distribution, no franking debit should arise in the company's franking account: see, in particular, item 1 of section 205-30, and subsection 202-5(b) which requires that a distribution must be a 'frankable' distribution for an entity to 'frank' the distribution.

Under the existing rules, the Commissioner may, on application by the company, determine that the company may change the franking credits attaching to a dividend by amending the relevant distribution statement.[13] This might become relevant if, for example, a dividend paid by the company is treated as unfrankable because of the new integrity rule but the company wishes to change the franking credits attaching to a subsequent dividend – which was only partially franked or unfranked (eg, because it was thought there were insufficient franking credits) – by amending the distribution statement in relation to the subsequent dividend. As a practical matter, in these circumstances, there is no certainty that the Commissioner would be willing to exercise his discretion to permit the company to change the franking credits attaching to that subsequent dividend. The Exposure Draft Legislation should be amended to expressly authorise companies to amend earlier distribution statements.

1.6.4 Retrospective operation

One of the most controversial and unfair aspects of the proposed integrity measure is its retrospectivity; in particular, if passed, the measure would apply to a distribution made at or after 12 noon (ACT time) on 19 December 2016, the date of the MYEFO Announcement.

To enable full retrospectivity, under the Exposure Draft Legislation section 170 of the 1936 Act will be modified so that the Commissioner is not prevented from amending an assessment that is issued before the commencement of these rules where the amendment is made within 12 months after commencement. In the absence of this change, the Commissioner would be confined, in the ordinary case, to the usual two or four year limitation period for amending assessments.

The expressed rationale for the retrospective operation of the integrity measure is to discourage entities from entering into such arrangements in the period between announcement of the measure and the eventual passage of the legislation:[14]

> The amendments apply retrospectively, in line with the announcement in the Government's 2016-17 Mid-Year Economic and Fiscal Outlook. This adversely affects those entities that have made or received affected distributions, contrary to this announcement.
>
> This is necessary because the measures prevent artificial and contrived arrangements set up to inappropriately access franking credits that were not intended under the imputation system. Allowing such activity to continue between announcement and the passage of legislation without any consequences under the law would encourage their use during this period.

This statement is based on the premise that the new integrity measure closely conforms with the measure announced in the MYEFO Announcement, which was designed to prevent 'artificial and contrived arrangements'. That premise is false. As explained above, the new integrity measure sweeps far more broadly than the MYEFO Announcement and potentially affects a significantly larger number of distributions beyond those addressed in the Taxpayer Alert, including many that are neither artificial nor contrived. Although 'the introduction of retrospective legislation is not done lightly'[15], one potential justification is that where a Government

[13] Section 202-85 of the 1997 Act.
[14] Exposure Draft Explanatory Materials to the *Treasury Laws Amendment (Measures for a later sitting) Bill 2022* (Cth) [1.55]-[1.56].
[15] Explanatory Memorandum to the *Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No 1) 2012* (Cth).

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announcement provides reasonable notice of the legislation that will be introduced taxpayers have a reasonable opportunity to organise their affairs appropriately. No such justification is available here. The MYEFO Announcement did not, in any way, provide reasonable notice to taxpayers about the proper scope of the integrity rule and taxpayers who entered into arrangements that are covered by the new integrity rule – but are not the subject of the Taxpayer Alert – could not reasonably have expected their arrangements to be covered. In addition, many of the taxpayers that will be affected by the proposed retrospectivity – and may be required to pay additional tax (and, presumably, interest) – will include individual shareholders in large listed companies. Requiring those shareholders to pay additional tax up to 6 years after dividends were paid is especially unfair.

The Government should abandon the proposed retrospectivity of the measure. If it retains its retrospective operation, it should limit it to arrangements that closely conform with the Taxpayer Alert and MYEFO Announcement or that were undertaken for the sole or dominant purpose of obtaining franking credits.

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2. Tax Exempt Employee Share Plans

2.1 Background

Many listed companies operate a 'tax exempt' employee share plan. Generally speaking, under these plans, participating employees acquire ordinary shares in a company for no consideration. Subject to satisfying certain conditions, including a 'minimum holding period' condition, the tax rules permit employees to reduce their assessable income by the amount of the discount from the acquisition of the ordinary shares under the plan (but the reduction of the assessable income of the employee cannot exceed more than $1,000 for an income year).

As discussed below, the Commissioner's application of the 'minimum holding period' (or 'disposal restriction') condition in the context of M&A transactions appears to have changed over time. Where previously the Commissioner accepted that a target's offer to participate in a tax exempt share plan after entry into a scheme implementation agreement did not breach these conditions, he no longer appears to accept this. His change in approach appears to have coincided with, and have been prompted by, a change in the statutory framework.

2.2 Former Division 13A

Prior to the rewrite of the employee share scheme rules in 2009, former Division 13A of the 1936 Act provided for the tax treatment of shares and rights acquired under employee share schemes. Similar to the current regime under Division 83A (discussed below), Division 13A brought to tax any discount on the market value of a share or right an employee acquired under an employee share scheme, subject to certain exclusions.

Generally speaking, under former Division 13A, employees participating in a qualifying employee share scheme that satisfied certain conditions could elect to be taxed on the discount in the year they acquired the shares or rights, and receive the benefit of a reduction of the discount by up to $1,000 (and prior to 1999, by up to $500) (this was known as the 'upfront concession').[16] To access the exemption, certain restrictions on disposal were imposed under former section 139CE:

> (3) The second condition is that the scheme was operated so that no recipient would be permitted to dispose of a share or right (the scheme share or scheme right) acquired under it, or of a share acquired as a result of a scheme right, before the earlier of the following times:
> (a) the end of the period of 3 years after the time of the acquisition of the scheme share or scheme right;
> (b) the time when the taxpayer ceased, or first ceased, to be employed by the employer.

This condition was similar to the 'minimum holding period' condition under former subsection 83A-35(8) in Division 83A of the 1997 Act (discussed below).

Where an employee's tax exempt shares were acquired under a scheme of arrangement before the completion of the three year period set out in former section 139CE, the Commissioner accepted that the shares would be disposed of pursuant to the scheme of arrangement, and that such a disposal would **not** be a breach of the condition in former section 139CE. This was on the basis that, according to the Commissioner, the acquisition under the scheme was considered to have no connection with the operation of the employee share scheme: see the various Class Rulings set out at **Annexure A**.

In most cases, the offer under the tax exempt employee share plan was made to employees **prior to** the entry into the Scheme Implementation Deed. There was, however, one notable exception. On 26 May 2008, St George Bank Ltd and Westpac Banking Corporation announced that they had signed a Merger Implementation Agreement for a proposed merger of the two companies. In CR 2008/13, the Commissioner ruled that employees

[16] See eg, Explanatory Memorandum, *Taxation Laws Amendment Act (No. 2) 1995* (Cth) [2.35].

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of St George Bank who would acquire a fully paid ordinary share in St George Bank in November 2008 – six months **after** the entry into the MIA – under the St George Employee Reward Share Plan and who would be required to dispose of those shares on implementation of the scheme of arrangement to Westpac:

- would **not** be in breach of the condition under former subsection 139CE(3); and
- would be entitled to exclude from their assessable income the discount of up to $1000 on those shares under subsection 139BA(2).

In particular, the Commissioner noted that:

> 32. The applicant has advised that the plan will be operated so that no participant will be permitted to dispose of shares prior to the end of the period of 3 years after the time they acquire them, other than in circumstances which will involve a cessation of employment within the meaning of subsection 139CE(5). That is, where the participant is no longer employed by the company that was their employer at the time the shares were acquired, unless the participant, on cessation of that employment is then employed with the group. Therefore, it is accepted that the plan will be operated up to the time of the implementation of the proposed scheme of arrangement, in a manner that will satisfy the second exemption condition.
>
> **33. Where shares are then disposed of pursuant to the implementation of the proposed scheme of arrangement, the Commissioner accepts that such a disposal is not a breach of the disposal restrictions in section 139CE, as the compulsory acquisition of the shares is considered to have no connection with the actual operation of the plan.** (emphasis added)

Under this reading, the critical statutory phrase in section 139CE(3) is 'the scheme was operated so that'; because the scheme of arrangement did not affect the operation of the employee share scheme, the holding period condition continued to be satisfied.

2.3 Division 83A – pre-2015

Similar to the position under former Division 13A, under Division 83A of the 1997 Act, employees may be entitled to reduce the amount included in their assessable income for an income year when they acquire shares under a qualifying employee share scheme. The tax exemption only applies where certain conditions are satisfied, including the 'minimum holding period' condition. Prior to 2015, the minimum holding period condition was framed in similar terms to former Division 13A. In particular, former subsection 83A-35(8) stated that:

> **83A-35 Reduction of amounts included in assessable income**
> *Minimum holding period*
> (8) This subsection applies to an *ESS interest you acquire under an *employee share scheme if, at all times during the period that:
> (a) starts when you acquire the interest; and
> (b) ends at the earlier of:
> (i) 3 years later; and
> (ii) when you cease being employed by your employer;
> the scheme is operated so that:
> (c) you are not permitted to dispose of:
> (i) any ESS interest (the scheme interest) you acquire under the scheme; or
> (ii) a beneficial interest in a *share you acquire as a result of a scheme interest; before the earlier of:
> (iii) the end of the period of 3 years after you acquire the scheme interest; and
> (iv) when you cease being employed by your employer; and
> (d) everyone else who acquires ESS interests under the scheme is subject to a corresponding restriction.

The Explanatory Memorandum to the *Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009* (at paragraph 1.131) explained the policy rationale of the minimum holding period condition:

> This minimum period ensures that the concession is only provided where there is sufficiently lengthy alignment of interests between the employee and employer. If the minimum holding period were not in place an employee could access the upfront tax concession, effectively receiving $1,000 in untaxed remuneration, and immediately sell the ESS interest for cash. This is not consistent with the intended aim of offering the tax concession in order to align employee and employer interests.

Where an employee's tax exempt shares were acquired under a scheme of arrangement prior to the completion of the three year period set out in former subsection 83A-35(8), the Commissioner previously accepted – similar to the position under former section 139CE – that the shares would be disposed of pursuant to the scheme of arrangement, and that such a disposal would **not** be a breach of the condition. This was confirmed by the Commissioner in the scheme of arrangement involving Crowe Horwath Australasia Ltd: see paragraph 134 of Class Ruling CR 2015/8. Based on publicly available information, it is not clear whether employees of Crowe Horwath were offered shares under the Crowe Horwath Exempt Share Plan before or after entry into the Scheme Implementation Agreement with Findex Australia Pty Ltd on 3 October 2014. Addressing the minimum holding period condition, the Commissioner ruled that:

> 133. Subsection 83A-35(8) of the ITAA 1997 requires the employee share scheme be operated so that participants are not permitted to dispose of an ESS interest acquired under the scheme before:
>
> • three years from the date they were acquired, or
>
> • the time the participating employee ceases employment with the employer.
>
> **134. The Commissioner accepts that where CRH shares are disposed of pursuant to the CRH Scheme, such a disposal is not a breach of this condition as the compulsory acquisition of the CRH shares under the CRH Scheme is considered to have no connection with the operation of the Share Plan.**

2.4 Division 83A – post-2015

The 'minimum holding period' condition under former subsection 83A-35(8) was repealed in 2015, and replaced with a similar but slightly different condition under subsection 83A-45(4). Most notably, the new provision – unlike its predecessors – granted the Commissioner a discretion to reduce the minimum holding period in situations in which all employees were effectively required to dispose of their shares.

> **83A-45 Further conditions for reducing amounts included in assessable income**
>
> *Minimum holding period*
>
> (4) This subsection applies to an *ESS interest you acquire under an *employee share scheme if, at all times during the interest's *minimum holding period, the scheme is operated so that every acquirer of an ESS interest (the ***scheme interest***) under the scheme is not permitted to dispose of:
> (a) the scheme interest; or
> (b) a beneficial interest in a *share acquired as a result of the scheme interest;
> during the scheme interest's minimum holding period.
>
> (5) An *ESS interest's ***minimum holding period*** is the period starting when the interest is acquired under the *employee share scheme and ending at the earlier of:
> (a) 3 years later, or such earlier time as the Commissioner allows if the Commissioner is satisfied that:
>
> > (i) the operators of the scheme intended for subsection (4) to apply to the interest during the 3 years after that acquisition of the interest; and
> > (ii) at the earlier time that the Commissioner allows, all *membership interests in the relevant company were disposed of under a particular *scheme; and
>
> (b) when the acquirer of the interest ceases being employed by the relevant employer.

Under the reformulated provision, the Commissioner may exercise his discretion to abridge the minimum holding period if he is satisfied that the 'operators' of the scheme *intended* for the minimum holding period to apply and at the earlier time that the Commissioner allows, all membership interests in the company are disposed of under a particular scheme. In other words, the new formulation under subsection 83A-45(5) appears to allow, and require, the Commissioner to consider the intention of the operators of the scheme and whether they ('genuinely') intended for the interests to be held by employees for the 3 years after acquisition. The Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (Employee Share Schemes) Bill 2015* (at paragraph 1.82) describes the scope of the Commissioner's discretion in the following terms.

> This Bill makes slight improvements to the existing minimum holding period condition by allowing the Commissioner to reduce the minimum holding period in situations in which all employees are effectively required to exercise and/or dispose of their employee share scheme interests. For example, where there is an initial public offering of the company, or the company is subject to a full trade sale and employees have agreed to a ‘tag along’ clause in relation to holding of minority interests. **The Commissioner in applying the discretion will need to have regard to whether, when employees acquired their interest, there was a genuine intention for the interests to be held for the minimum holding period.** (emphasis added)

The introduction of a discretion to abridge the minimum holding period under subsection 83A-45(5) has apparently changed the Commissioner's approach to the disposal of tax exempt employee share scheme interests in connection with a scheme of arrangement. Since the introduction of subsection 83A-45(5), the Commissioner has not published any Class Ruling that has reaffirmed the approach outlined above in the context of former subsection 83A-34(8) or former subsection 139CE(5) – namely, where he accepted the view that a compulsory acquisition of shares under a scheme of arrangement had 'no connection' with the operation of the employee share scheme. Instead, the Commissioner is apparently proceeding on the contrary basis that the scheme of arrangement does affect the operation of an employee share scheme and it is therefore necessary to invoke his discretion in connection with employee share scheme interests granted in the preceding three years.

In deciding whether to exercise a discretion under subsection 83A-45(5)(a) to abridge the minimum holding period to end on the implementation date under the scheme – ie, the date that the shares are disposed of under the scheme – the Commissioner appears to focus on whether there is objective evidence to suggest that, at the time employees acquired shares under the tax exempt employee share plan, the company had formally engaged with a prospective purchaser in respect of a transaction involving the disposal of shares in the company. For example, if the company had received a non-binding indicative proposal from, or entered into a scheme implementation deed with, a prospective purchaser at the time the shares under the plan were offered to employees, according to the Commissioner, that would suggest that the company did not have a genuine intention for employees to hold the shares offered under the plan for a 3 year period.

The table at **Annexure A** sets out the recent Class Rulings requesting the Commissioner to exercise his discretion under section 83A-45(5). In all but one instance, the Commissioner agreed to abridge the minimum holding period – on that occasion (involving Class Limited), shares were offered to employees under the plan **after** the company had entered into a scheme implementation deed with a prospective purchaser.

2.5 Class Limited Tax Exempt Employee Share Plan

On 18 October 2021, Class Limited (***Class***) entered into a Scheme Implementation Deed with Hub 24 Limited (HUB24) for the acquisition of 100% of the ordinary shares in Class in exchange for HUB24 shares pursuant to a scheme of arrangement under Part 5.1 of the Corporations Act.[17] Pursuant to the Scheme Implementation Deed, the Scheme Consideration was paid, and Class shares were transferred to HUB24, on the Scheme Implementation Date, 16 February 2022.[18] Prior to the entry into the Scheme Implementation Deed, Class

[17] Class Ruling CR 2022/45 (paragraph 15).
[18] Class Ruling CR 2022/45 (paragraph 18).

established a Tax Exempt Employee Share Plan (***TEESP***) on 21 September 2015.[19] The TEESP was an employee share scheme for the purposes of section 83A-10. The TEESP provided qualifying employees with the opportunity to acquire up to $1,000 worth of ordinary shares in Class (for no consideration).[20]

Class offered shares to qualifying employees in three tranches in 2019,[21] 2020[22] and 2021. Shares acquired under the 2021 Tranche were offered by Class to qualifying employees on 1 December 2021 and issued to participants on 22 December 2021.[23]

The Class Board amended the TEESP Rules on 28 January 2022 so that on the Effective Date, 4 February 2022 when the Supreme Court of NSW approved the Scheme of Arrangement, if there was a Holding Lock Period applicable to any TEESP shares that ended on a date after the Implementation Date, that Holding Lock Period would automatically end on the Implementation Date.[24] Once the Holding Lock was removed, the shares were acquired by HUB24 pursuant to the Scheme of Arrangement on 16 February 2022.[25]

In Class Ruling CR 2022/45, the Commissioner ruled that he would exercise his discretion under subsection 83A-45(5) to allow the minimum holding period to end at the earlier time of 16 February 2022 (Scheme Implementation Date) for the TEESP shares acquired under the 2019 and 2020 Tranches and disposed of under the Scheme of Arrangement.[26] The Commissioner, however, did **not** allow the minimum holding period to end at the earlier time of 16 February 2022 for the TEESP shares acquired under the 2021 Tranche.

According to the Class Ruling, the Commissioner was not satisfied that, at the time of the issue of the 2021 Tranche shares on 22 December 2021, the operators of the scheme intended the employee share scheme to apply to the share during the 3 years after that acquisition of the interest given the fact that the conditional, non-binding and indicative proposal from HUB24 to acquire all of the shares in Class by way of a scheme of arrangement had been received and the Scheme Implementation Deed had been executed prior to the 2021 Tranche being offered to qualifying employees.[27] The Commissioner stated:

> **2021 Tranche Class Limited Tax Exempt Employee Share Plan Shares**
>
> 39. CLTEESP Shares acquired under the 2021 Tranche were offered by Class to qualifying employees on 1 December 2021 and were issued on 22 December 2021. Prior to the 2021 Tranche being offered, the conditional, non-binding and indicative proposal from HUB24 to acquire all of the shares in Class by way of a scheme of arrangement had been received and the SID had been executed.
>
> 40.In these circumstances, for the 2021 Tranche, the Commissioner is not satisfied that the requirement of subparagraph 83A-45(5)(a)(i) is met. Accordingly, the Commissioner will not allow the minimum holding period to end at the earlier time of 16 February 2022 for the CLTEESP Shares issued under the 2021 Tranche.

2.6 Comment on Commissioner's apparent new approach

In our view, the apparent change in the Commissioner's practice after the 2015 amendments requires additional explanation. The conferral of a discretion on the Commissioner to abridge the minimum holding period was evidently intended to be favourable to taxpayers. But the basic framework of the minimum holding condition in section 83A-45(4)-(5) otherwise resembles its predecessors. In the reformulated provision, as in its predecessors,

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[19] Class Ruling CR 2022/45 (paragraph 20).
[20] Class Ruling CR 2022/45 (paragraph 20-21).
[21] Class Ruling CR 2022/45 (paragraph 22).
[22] Class Ruling CR 2022/45 (paragraph 23).
[23] Class Ruling CR 2022/45 (paragraph 24).
[24] Class Ruling CR 2022/45 (paragraph 28). It is not clear whether any of the past class rulings issued by the Commissioner under former section 83A-35 and former section 139CE similarly involved an amendment to the plan rules which had the effect of varying the holding lock attaching to the shares issued under the employee share scheme, though it is likely they do.
[25] Class Ruling CR 2022/45 (paragraph 29).
[26] Class Ruling CR 2022/45 (paragraph 6).
[27] Class Ruling CR 2022/45 (paragraphs 7 and 39-40).

what is critical is that the 'scheme is operated' so that employees cannot dispose of their interests within three years. The Commissioner has previously ruled that the effect of a scheme of arrangement does not affect the operation of an employee share scheme, including one entered into after the scheme commences. That reasoning should not change because Commissioner *also* has a discretion to abridge the holding period. Indeed, to justify a worse result for taxpayers on the basis of the inclusion of a discretion designed to be favourable to taxpayers generally is an odd way to interpret legislation.

If the Commissioner has changed his view about whether entry into a scheme of arrangement does affect the operation of an employee share scheme, as he seems to have, he should say so explicitly. His change in approach has both a practical and substantive aspect. The practical aspect is that taxpayers who acquired interests in the three years before the scheme must seek the exercise of the Commissioner's discretion to abridge the holding period. The substantive aspect is that, apparently, the Commissioner will not abridge the minimum holding period for interests granted after the commencement of the scheme of arrangement (or even after when there has been substantive engagement with a prospective purchaser), resulting in a worse result for employees compared to the previous legislation.

3. Shareholder Capital Contributions – *Aurizon*

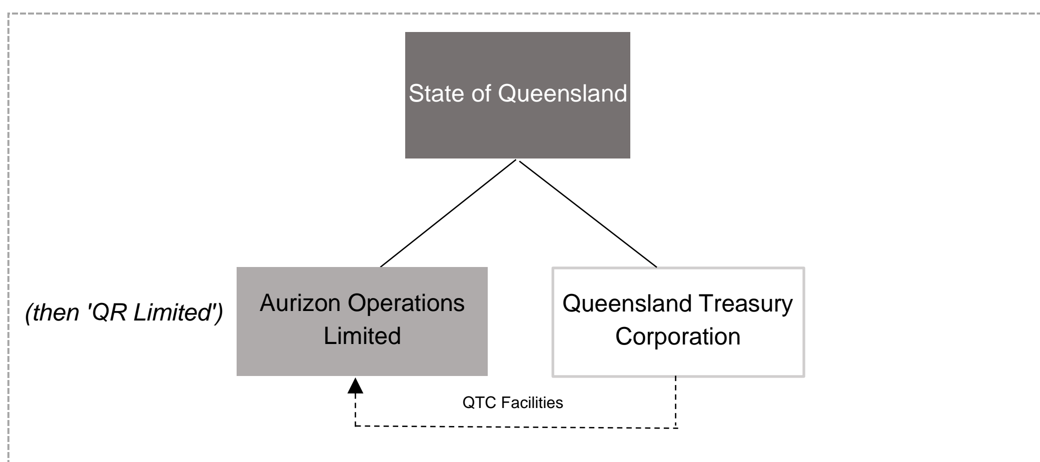
3.1 Introduction

Justice Thawley of the Federal Court in *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368 recently considered whether a contribution made by the State of Queensland to Aurizon Holdings Limited (***Aurizon***) – for 'nil' consideration and without the issue of additional shares in the company – in connection with the public float of Aurizon was 'share capital' for tax purposes. In summary, the Court ruled in favour of the taxpayer, and held that the State Contribution (defined below) was an amount of 'share capital', and that the account to which the State Contribution was credited was a 'share capital account' for the purposes of section 975-300(1) of the 1997 Act. The Court also granted declaratory relief despite the Commissioner's argument that a private ruling was an alternative and more appropriate remedy in the circumstances.

Following the decision, the ATO published a Decision Impact Statement. In the Decision Impact Statement, the ATO (unsurprisingly) purports to limit the decision in *Aurizon* to its 'unusual' facts.

3.2 Factual Background

Aurizon Operations Limited (***Aurizon Operations***) was wholly owned by the State of Queensland and operated the State's coal and freight businesses. Debt facilities (***QTC Facilities***) were made available to Aurizon Operations by Queensland Treasury Corporation (***QTC***), another state-owned corporation.[28]



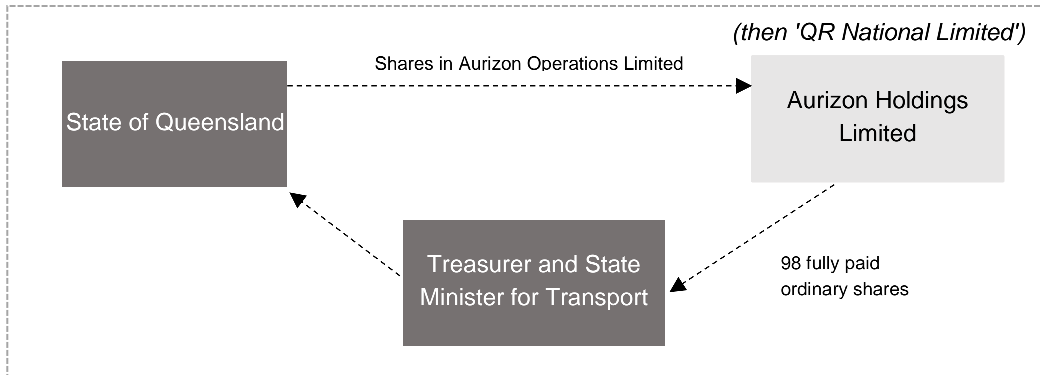
In 2009, the Queensland Government announced the public floatation and listing on the ASX of Aurizon Operation's coal and freight network under the name ***QR National***. The Government's objective was to dispose of 60% to 75% of its interest in the network through an IPO of the shares in a newly established company, Aurizon. To achieve this objective, the parties undertook a series of steps pursuant to directions issued by the Treasurer under the *Infrastructure Investment (Asset Restructuring and Disposal) Act 2009* (Qld) (***Infrastructure Act***):[29]

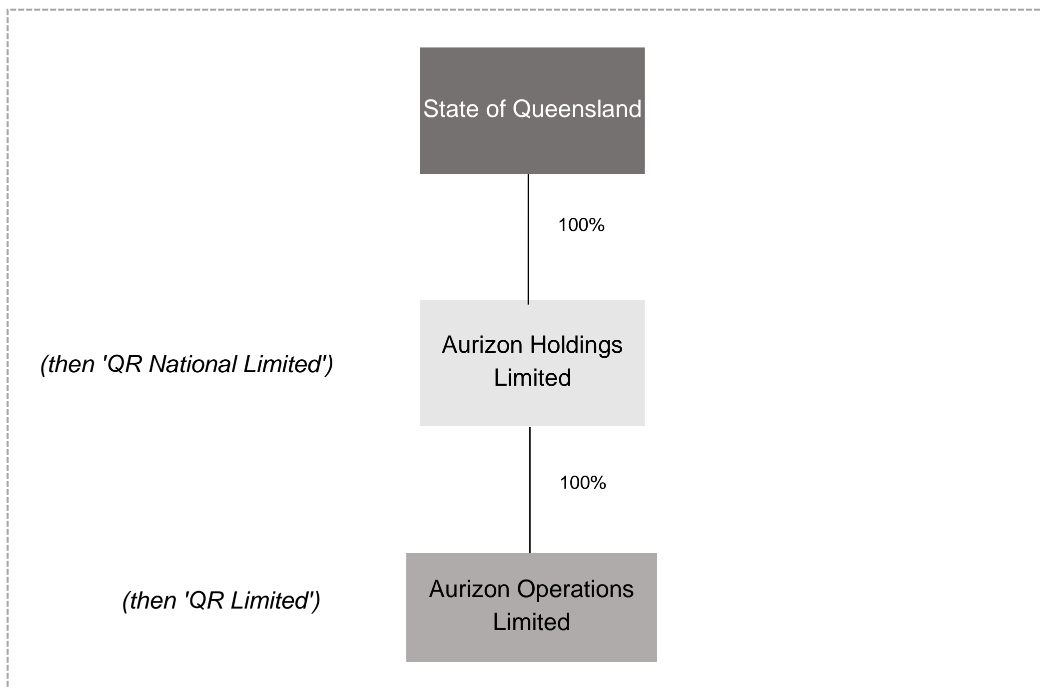
1. Aurizon was incorporated on 14 September 2010 with two ordinary shares fully paid at $1 each issued to the Treasurer and State Minister for Transport, who held shares on behalf of the State of Queensland. The issue

[28] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [10] per Thawley J.
[29] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [14], [17] per Thawley J.

price for those shares was credited to an account labelled 'Authorised Capital' in the general ledger of Aurizon.[30] As noted by Thawley J, the Authorised Capital account was "plainly" a share capital account.[31]

2. All of the issued shares in Aurizon Operations were transferred from the State of Queensland to Aurizon. The consideration for the transfer was the issue of 98 fully paid ordinary shares in Aurizon to be held in equal proportions by the Treasurer and State Minister for Transport on behalf of the State of Queensland.[32]





3. The 100 fully paid ordinary shares issued by Aurizon were converted to 2,440,000,000 ordinary shares.[33]

4. Aurizon Operations' aggregate indebtedness under the QTC Facilities was fixed at $4,388,252,224 (***QR Debt***).[34]

5. Aurizon Operations' debt to QTC was transferred to the State of Queensland, so that the State of Queensland became indebted to QTC rather than Aurizon Operations. Aurizon Operations thereafter began to owe the

[30] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [22] per Thawley J.
[31] Ibid.
[32] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [23], [26] per Thawley J.
[33] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [32], [34] per Thawley J.
[34] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [38] per Thawley J.

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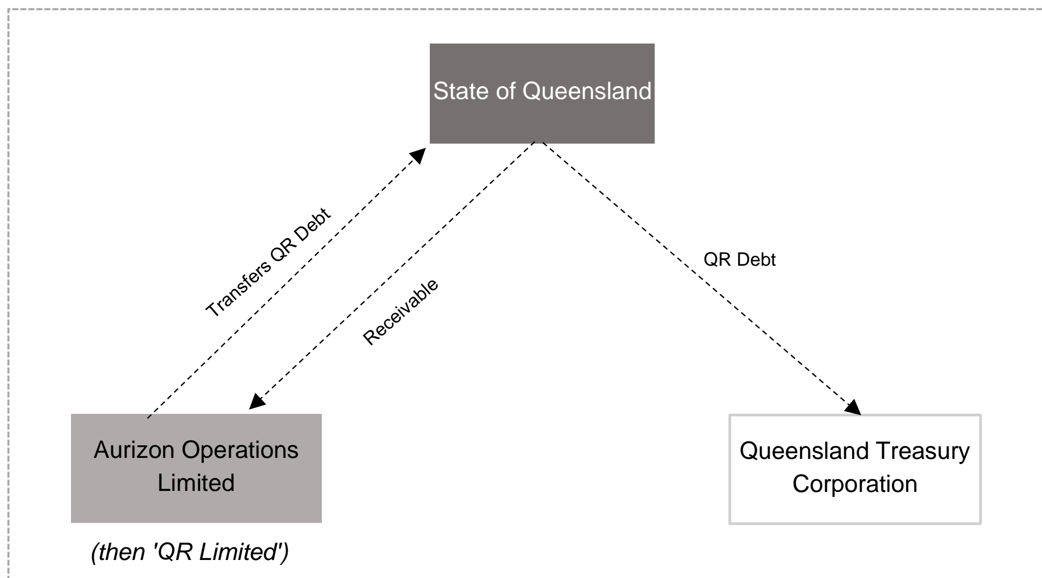
State of Queensland an amount equal to the QR Debt, creating a ***Receivable*** in favour of the State of Queensland.[35]

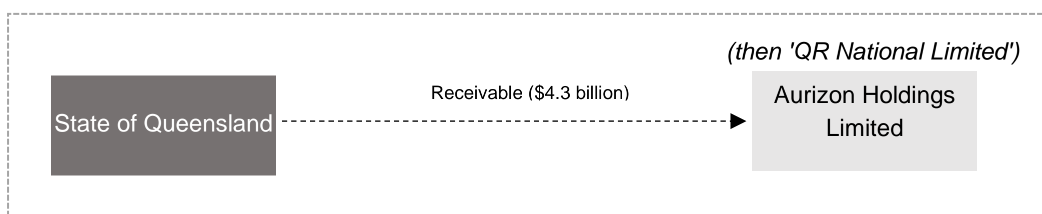


6. Under a 'Transfer Notice – Project Direction' (***Project Direction***) issued under the Infrastructure Act, the State of Queensland's right, title and interest in the Receivable was transferred to Aurizon (the ***State Contribution***).[36] The Project Direction provided that:

   a) the consideration for the transfer of the Receivable from the State to Aurizon was **nil**; and

   b) the transfer of the Receivable from the State to Aurizon would be **designated** to be a contribution by the State and to be adjusted against the contributed equity of Aurizon.

   The amount of the Receivable was credited to a separate 'Capital Distribution' account.[37] The minutes of the meeting of the directors of Aurizon recorded that the transfer of the Receivable was a 'contribution of equity' from the State to Aurizon 'in accordance with AASB Interpretation 1038'.



7. The Receivable was discharged by Aurizon subscribing for 5.2 billion additional shares in Aurizon Operations and the Receivable then owing by Aurizon Operations to Aurizon being set off against the subscription price.[38]

[35] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [39] per Thawley J.
[36] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [40] per Thawley J
[37] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [49] per Thawley J.
[38] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [50] per Thawley J.

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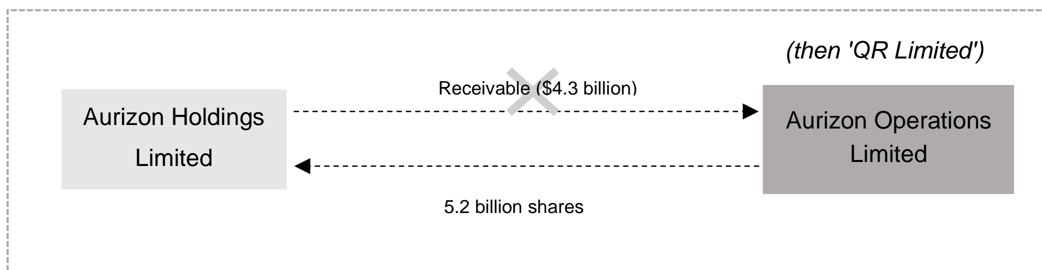

3.3 Summary of parties' arguments

Taxpayer's key submissions

- Aurizon contended that the State Contribution was made by the State of Queensland in its capacity as shareholder and was not a loan or gift or, alternatively, that the State Contribution was sufficiently connected to an earlier issue of shares to the Queensland Government.[39] In its primary submission, Aurizon submitted that *any* money or property contributed by a member, in that capacity, to a company is share capital, except if it is made by a way of loan or gift.

- Aurizon sought declarations to the effect that the 'Authorised Capital' and 'Capital Distribution' accounts were 'share capital accounts' for the purposes of section 975-300(1) of the 1997 Act and that they were to be taken to be a single share capital account in accordance with section 975-300(2).[40]

Commissioner's key submissions

- While the Commissioner accepted that the Authorised Capital account was a share capital account, he denied that the Capital Distribution account was a share capital account. He argued that the State Contribution formed part of the assets in excess of Aurizon's share capital that affect the value of the company and, by extension, its shareholders' equity. In support, he pointed out that the State Contribution was expressly made for 'nil' consideration, was not made in exchange for the issue of any shares and was recorded in a different account from the account involving the allotment of shares in the company.[41]

- The Commissioner also submitted that the Court should decline declaratory relief, since a private ruling was a more appropriate remedy for Aurizon.[42]

3.4 The Contribution was Share Capital

The Federal Court ruled that the State Contribution was share capital.[43] Even though the Project Direction expressly stated that the consideration for the State Contribution was 'nil', the Court considered that this statement, when read in context, purported to make clear that the contribution was not a loan and that it was a contribution for which further shares would not be issued.

In arriving at this conclusion, Thawley J found that:

- Cases such as *Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143, *Re the Swan Brewery Co Ltd* (1976) 3 ACLR 164, *Cable & Wireless Australia & Pacific Holding BV (in*

[39] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [53] per Thawley J.
[40] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [1] per Thawley J.
[41] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [55]-[57] per Thawley J.
[42] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [104] per Thawley J.
[43] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [100] per Thawley J.

liquidatie) v Commissioner of Taxation (1027) 251 FCR 483, *Kellar v Williams* [2000] 2 BCLC 390 and *The Commissioners for HM Revenue and Customs v Alan Blackburn Sports Limited* [2008] EWCA Civ 1454 did **not** support Aurizon's contention that, as a general principle, any money or property contributed by a member, in that capacity, to a company is share capital, except if it is made by way of loan or gift.[44] Instead, Thawley J considered those cases generally reaffirmed the Commissioner's position that members may make contributions of equity that are not share capital.[45]

- The cases outlined above did not necessarily eliminate the possibility of share capital existing in a scenario such as this where the contemporaneous evidence suggested that the State Contribution was, in fact, intended to form part of share capital despite no shares being issued – while the cases relied on by the taxpayer did consider what typically constitutes share capital, according to Thawley J, they did not consider the precise issue raised before the court:

> …namely, the classification of an amount paid to a company by its sole shareholder, expressed to be for 'nil consideration' and not in exchange for a new issue of shares, but which was to be adjusted to the contributed equity of the company, that contributed equity at the time being constituted only by share capital.[46]

- Thawley J said that the plain language of the State Contribution being made for 'nil consideration' in the Project Direction needed to be read in the context of the whole document, as well as the context of the known background leading to the production of that document[47] – to that end, the words 'nil consideration' merely meant that the State Contribution was not a loan and that it was a contribution for which further shares would not be issued.[48]

- The evidence suggested that the word 'designate' was used in the Project Direction because of Australian Accounting Standard AASB Interpretation 1038 (***Interpretation 1038***), which addresses 'contributions by owners made to wholly-owned public sector entities'. A close examination of Interpretation 1038 revealed that a 'formal designation' is intended to reflect an ownership interest capable of redemption and thus one which should be recognised directly in equity. While the accounting treatment was not determinative of the legal nature of the State Contribution, Thawley J found that it formed part of the objective evidence of the State of Queensland's intention of making a capital contribution to be reflected as share capital, rather than a gift.[49]

- Finally, there were other factors weighing in favour of the conclusion that the State Contribution was share capital, namely:

  - It was originally planned that the State Contribution would be made in exchange for shares. The transaction steps were altered simply to ensure that the correct number of shares existed at the time of the time of the float.[50]

  - A consolidated balance sheet in the Offer Document contemplated an increase to 'contributed equity' by $4.007 billion, as well as a $4.226 billion reduction in liabilities.[51]

[44] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [95] per Thawley J.
[45] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [95] per Thawley J.
[46] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [67] per Thawley J.
[47] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [97] per Thawley J.
[48] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [98] per Thawley J.
[49] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [99] per Thawley J.
[50] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [101] per Thawley J.
[51] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [101] per Thawley J.

- The Project Direction also indicated that the State Contribution was to be 'adjusted against the contributed equity', suggesting that the contribution was intended to be share capital despite no new shares being issued.[52]

- No evidence suggested 'any good or proper reason for intending that the Contribution be something other than share capital'.[53] In particular, it was unlikely that it was intended that the State Contribution not be subject to the limitations in Part 2J.1 of the *Corporations Act 2001* (Cth).[54]

Accordingly, although 'the term "share capital" almost invariably refers to the capital contributed to a company in exchange for shares', *Aurizon* stands for the proportion that this does not necessarily 'supply an exhaustive definition of share capital'.[55]

3.5 Declaratory Relief Granted

The Commissioner submitted that the Court should decline declaratory relief because there was an alternative and more appropriate remedy that was available to Aurizon. According to the Commissioner, the appropriate remedy was for Aurizon to seek a private ruling from the Commissioner and, if it did not agree with that ruling, to bring proceedings under Part IVC of the *Taxation Administration Act 1953* (Cth).[56]

The Court rejected the Commissioner's submission. Thawley J noted that the object of the statutory regime for private binding rulings is to provide a way for taxpayers to find out the Commissioner's view about how certain laws administered by the Commissioner apply to the taxpayer so that the risks to the taxpayer of uncertainty when self-assessing or working out tax obligations or entitlements are reduced.[57] His Honour considered that the private ruling regime was not well suited to dealing efficiently with the question Aurizon raised for several reasons:

- First, it would have been particularly difficult to identify with any certainty the relevant facts upon which the ruling would be made.[58] It was only shortly before the hearing that the parties agreed on a number of relevant facts, with other facts only being perceived to be relevant and made the subject of evidence during the course of the hearing.

- Second, any appeal would have been confined to the facts put in the private ruling application, and Thawley J noted that it was likely that the facts in the private ruling application would have been shown to be wrong in some respect in any Part IVC appeal, requiring the whole process to miscarry and need to start again.[59]

- Third, third parties such as Aurizon's shareholders had an interest in the issue being resolved in a way that binds the Commissioner, making the private binding ruling an inappropriate remedy in the circumstances because although it might be binding on the Commissioner in relation to Aurizon, it would not be binding in relation to any third parties, such as Aurizon's shareholders.[60]

[52] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [99] per Thawley J.
[53] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [101] per Thawley J.
[54] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [101] per Thawley J.
[55] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [7] per Thawley J.
[56] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [105] per Thawley J.
[57] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [108] per Thawley J.
[58] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [108] per Thawley J.
[59] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [108] per Thawley J.
[60] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [108] per Thawley J.

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3.6 ATO Decision Impact Statement and Key Takeaways

Justice Thawley's judgment confirms that, in some circumstances at least, a contribution by a shareholder will be share capital even where no shares are issued. But what are those circumstances? Or, expressed another way, what rule or standard did Thawley J apply in determining that the State Contribution was a contribution to share capital? Although not stated explicitly as the applicable standard, the touchstone of his Honour's analysis appears to be the parties' (or, at least, the shareholder's) objective intention – that is, their intentions ascertained objectively from their statements, documents and other contextual materials. His Honour refers to the importance of intention in multiple places throughout his judgment, including in the dispositive parts of his analysis.[61]

The ATO recently published its indicative views on *Aurizon* in a Decision Impact Statement. The ATO is (unsurprisingly) seeking to confine the decision in *Aurizon* to its facts, and considers the decision to support its pre-existing views on what constitutes share capital for tax purposes. More broadly, the ATO rejects any suggestion that *Aurizon* should stand for any general principle that capital contributions without the issue of share capital should always constitute 'share capital' for tax purposes.

Notably, the ATO Decision Impact Statement explains:

> It is the ATO's view that this decision has very limited application beyond its own factual circumstances. His Honour makes it clear that ultimately it was a case that turned on its own particular facts and circumstances. Noting the unusual circumstances of this particular matter, it is the Commissioner's view that the decision reaffirms the pre-existing view as to what generally is to be treated as share capital, with His Honour stating at [7] that '...[t]he term "share capital" almost invariably refers to the capital contributed to a company in exchange for shares.'
>
> The Commissioner considers that the approach in this case as to what constitutes share capital **will only be relevant in the unusual circumstance where there is clear contemporaneous evidence that the objective intention was that the relevant amount was always meant to be a contribution to share capital**. (emphasis added)

We consider that the key practical takeaways from *Aurizon* and the Decision Impact Statement are as follows:

1. Where possible, capital contributions should be made in exchange for the issue of shares. In *Aurizon*, it was incontestable that if shares had been issued in exchange for the State Contribution, as originally planned, that would 'unarguably' have been share capital.[62] As discussed below, this approach would also, in most contexts, simplify the cost base analysis.

2. If issuing shares is not possible, it is important to ensure that there is compelling and clear contemporaneous evidence supporting the parties' intentions to treat the contributions as 'share capital' for tax purposes, including based on the following documents:

   a) **constituent documents** – does the company's constitution expressly permit a contribution to be made without the issue of shares?;[63]

   b) **board resolutions and minutes** – do these documents expressly describe the contribution as an adjustment to share capital?; and

   c) **accounting entries** – how is the capital contribution recognised for accounting purposes, and are there specific accounting standards which should be considered?

[61] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [8], [99]-[101] per Thawley J

[62] *Aurizon Holdings Ltd v Federal Commissioner of Taxation* [2022] FCA 368, [20] per Thawley J.

[63] We understand there is, in addition, some uncertainty about the status of capital contributions without the issue of shares under the *Corporations Act 2001* (Cth).

3.7 What about cost base?

3.7.1 Shares issued in exchange for capital contribution

Where a capital contribution is made by a shareholder to a company in exchange for shares in the company, the amount of the capital contribution should generally be included in the first element of the cost base and reduced cost base of the new shares acquired by the shareholder.[64]

This is subject to any modification under the market value substitution rule in section 112-20 of the 1997 Act, which would apply if, (A) the shareholder and the company were not dealing at arm's length; and (B) the capital contribution paid for the shares exceeded the market value of the shares. On (B), if, for example, the company's net asset position caused it to breach a debt covenant under its financing facilities (eg, to maintain a particular loan to equity ratio), and the capital contribution was required to remedy that breach, the market value of the new shares issued by the company in that scenario may not be equal to the capital contribution paid to acquire the shares. The Commissioner considered a similar scenario in ATO ID 2003/235 (withdrawn)[65] where:

- a shareholder contributed funds to a company that had a 'net asset deficiency' and required additional funds to continue business operations;
- the amount contributed by the shareholder to acquire shares was greater than the market value of the shares; and
- the shareholder and the company were not dealing at arm's length in relation to the acquisition of the shares.

The Commissioner ruled that the market value substitution rule would apply in these circumstances to adjust the first element of the cost base and reduced cost base of the shares to the market value of the shares at the time of acquisition. The Commissioner also noted that whether parties have dealt at arm's length, and what the market value of a share is, are questions of fact that must be determined in any particular case.

If the market value substitution rule applied, it would preclude that part of the capital contribution that would, in the absence of the rule applying, being included in the first element of cost base and reduced cost base from being deductible under section 40-880. This is because section 40-880(8) expressly prevents a deduction to the extent that an amount of expenditure was excluded from the cost base or reduced cost base of a CGT asset because of the market value substitution rule. Nevertheless, we think there are good technical arguments that the balance of any amount reduced under the market value substitution rule should be included in the fourth element of cost base of the existing shares.[66] This result aligns this scenario with the position, discussed below, for capital contributions made in analogous circumstances without the issue of shares.

[64] Sections 110-25(2) and 110-55(2) of the 1997 Act. This assumes, of course, that the shareholder and company are not part of a tax consolidated group.
[65] Although ATOID 2003/235 was withdrawn by the Commissioner in 2014, it was withdrawn because "it is a straightforward application of the law".
[66] The ATO previously accepted this position in a series of private binding rulings, including PBR 1012864435050. We understand that the ATO may no longer accept this position as correct, since it has included a statement in those private binding rulings cautioning that the ruling is misleading or incorrect.

3.7.2 No shares issued in exchange for capital contribution

3.7.2.1 Capital contributions to wholly owned subsidiaries

Where, however, a capital contribution is made by a shareholder to a company **without** any new shares being issued by the company, there is a question whether, and on what basis, the additional contribution should be treated as part of the 'cost base' (or reduced cost base) of the existing shares held by the shareholder.[67] This question is likely to turn on whether the capital contribution can be included in the fourth element of the cost base and reduced cost base of the existing shares in the company. In other words, the question is whether it can be established that the purpose or expected effect of the capital contribution is to increase or preserve the value of the existing shares held by the shareholder for the purposes of sections 110-25(5) and 110-55(2). Subsection 110-25(5), for example, provides that:

> The fourth element is capital expenditure you incurred: (a) the purpose or expected effect of which is to increase or preserve the asset's value…

In Taxation Determination TD 2014/14, the ATO considered the tax treatment of certain 'capital support payments' which, broadly, are described as payments made by a parent entity to a subsidiary because the subsidiary made a loss or was not sufficiently profitable (or would likely have made a loss or not been sufficiently profitable if it were not for the payment). The Commissioner accepted that these 'capital support payments' should be included in the fourth element of the cost base and reduced cost base of the parent's (direct or indirect) investment in a subsidiary. In particular, the TD states:

> 71. A capital support payment is, or has substantially the effect of, a non-scrip capital contribution to the subsidiary. It preserves or increases the value of the parent's investment in the subsidiary, even though the subsidiary does not issue additional membership interests.
>
> …
>
> 93. The fourth element of cost base and reduced cost base comprises capital expenditure incurred for the purpose or the expected effect of increasing or preserving the value of the CGT asset (subsections 110-25(5) and 110-55(2)). The objective purpose and effect of a capital support payment is to increase or preserve the value of a parent's investment in a subsidiary. A capital support payment is therefore considered to be included in the fourth element of the cost base and reduced cost base of a parent's direct or indirect investment in the subsidiary.
>
> 94. To the extent that the parent holds its investment directly by owning membership interests in the subsidiary, the payment is included in the cost bases and reduced cost bases of those interests. To the extent that the parent holds its investment indirectly through interposed entities, the payment is included in the cost bases and reduced cost bases of the parent's interests in those entities.

By parity of reasoning, there is a strong argument that a capital contribution made by a 'parent' (or shareholder) in a subsidiary – where there are no shares issued in exchange for the capital contribution and which may form part of the subsidiary's share capital – should be included in the fourth element of the cost base and reduced cost base of the existing shares held by the parent (or shareholder) provided that the purpose or expected effect of the capital contribution is to increase or preserve the value of the existing shares held by the parent in the subsidiary. The Commissioner appears to have accepted this position in a number of private binding rulings.[68]

As the Commissioner's approach in TD 2014/14 illustrates, this position should apply even where the value of the company's net assets is low or negative.[69]

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[67] Again, disregarding, for present purposes, a scenario where shareholder and company are part of a tax consolidated group.

[68] See, for example, PBR 1051525961483, 1012458982395, 1012490698221 and 1012819279900.

[69] In other words, the Commissioner does not appear to have argued that capital expenditure can only increase or preserve an asset's value where the asset has a positive value before or after the expenditure is incurred.

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A capital contribution which is included in the fourth element of cost base should not be subject to modification under the market value substitution rule in section 112-20, which only affects the first element of cost base.

3.7.2.2 Capital contributions to non-wholly owned subsidiaries

In each of the private binding rulings referred to above, the capital contribution was made by the *sole shareholder* of the company. In TD 2014/14, the ATO (apparently) does not confine its views to this context – in particular, it defines the relevant parent and subsidiary relationship by adopting the definition of a 'subsidiary' under section 46 of the *Corporation Act 2001* (Cth), which would extend to a majority shareholder.[70] Nevertheless, where only one of a number of shareholders in a company makes a capital contribution without the issue of shares in the company, there is a question whether, and the extent to which, the purpose or expected effect of the capital contribution is to increase or preserve the value of that shareholder's existing shares in the company for the purposes of the fourth element of cost base (and reduced cost base).[71]

In considering this question, it is instructive to consider the scope of the previous versions of sections 110-25(5) and 110-55(2) of the 1997 Act, as well as their predecessors in former sections 160ZH(1)(c), (2)(c) and (3)(c) of the 1936 Act. The previous version of section 110-25(5), for example, provided that the cost base of a CGT asset included:

> The fourth element is capital expenditure you incurred to increase the asset's value. However, the expenditure must be reflected in the **state or nature of the asset** at the time of the event. (The expenditure can include giving property: see section 103-5).

In Taxation Determination TD 2004/2 (now withdrawn), the Commissioner considered to what extent a 'non-scrip share capital contribution' to a company could be included in the cost base or reduced cost base of a share in that company for the purposes of these provisions. As relevant here, the Commissioner reached several important conclusions:

1. The reference to 'state or nature' did **not** include a reference to value.
2. Where the rights of the shareholder making the capital contribution are varied so that they are solely entitled to any return of the share capital in connection with the capital contribution, the capital contribution could be included in the fourth element of the cost base and reduced cost base of the shares because the variation in the shares affect their 'nature'.[72]
3. Where the rights attaching to the existing shares are not varied as a result of, or in connection with, the capital contribution, the Commissioner accepted 'on balance' that the capital contribution could still satisfy the fourth element provided that the contribution is directly associated with, or directly linked to, an increase in the absolute amount of share capital that the shareholder is entitled to in respect of the shares, and the entitlement must still be present when a CGT event happens to the share.
4. Where the rights attaching to the existing shares are not varied as a result of, or in connection with, the capital contribution, and where the shareholder did not hold all the shares, the amount included in the fourth element would not be the entire amount of the contribution, but such amount that reflected the shareholder's proportionate shareholding.[73]

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[70] See paragraphs 13 and 62. For the purposes of section 46 of the Corporations Act, a body corporate is a subsidiary of another body corporate if the other body is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the first body. For the purposes of applying this test to an entity other than a body corporate, the ATO assumes (for the purposes of the Taxation Determination) that the entity would be a body corporate.

[71] For completeness, we would generally expect that the direct value shifting rules in Division 725 of the 1997 Act should not apply in circumstances where, as a consequence of a capital contribution made by one shareholder, the market value of all the shares on issue in the company increase.

[72] As an aside, the Taxation Determination appears to proceed on the basis that the capital contribution would be share capital: see paragraph 11.

[73] As an (additional) aside, the Taxation Determination queries whether a non-share capital contribution of this kind would be permissible under corporations law. The Commissioner notes in this regard, "*13. Advice has been received from the Attorney General's Department of*

Expanding on 4, the Commissioner considered a scenario whereby a 'non-scrip share capital contribution' was made by a shareholder that owned only 50% of the shares in the company. Example 1 of TD 2004/2W stated:

> *Example 1*
>
> 20. *Alpha Co and Delta Co each has a 50% shareholding in Beta Co. Alpha Co contributes additional share capital directly to Beta Co as this is permitted by the corporations law in the jurisdiction in which Beta Co is registered. No additional shares are issued by Beta Co. The rights attaching to Alpha Co's existing shares are simultaneously varied to ensure that they are solely entitled, upon any return of share capital, to receive the additional contribution.*
>
> 21. *The nature of Alpha Co's shares is changed because the contribution is accompanied by a change in the shares' constituent rights. The capital contribution could satisfy the requirement that the expenditure be reflected in the state or nature of each share when a CGT event later happened to it. Provided the other conditions for the application of fourth element expenditure are met (that is, the expenditure is of a capital nature ... incurred to increase the value of the shares), the capital contribution can be included in the fourth element of the cost base and reduced cost base of the shares.*
>
> **22. *Note that if the rights attaching to Alpha Co's existing shares were not changed, the maximum amount the Commissioner would accept as eligible for inclusion in the fourth element would be 50% of the total contribution.***

The Commissioner withdrew Taxation Determination TD 2004/2 as a result of the Full Federal Court's decision in *National Mutual Life Association of Australia Ltd v Commissioner of Taxation* (2009) 177 FCR 539; [2009] FCAFC 96. There a majority of the Full Federal Court (Finn and Sundberg JJ) rejected the Commissioner's conclusion at 1. above – that is, the majority found that 'state or nature' was sufficiently broad as to encompass value. Despite its withdrawal, it is interesting, and relevant, that the Commissioner previously considered that at least a portion of the capital commitment would form part of the fourth element. That conclusion is not relevantly affected by the Full Federal Court's conclusion in *National Mutual Life Association*.

In 2006, Parliament enacted the modern versions of sections 110-25(5) and 110-55(2). The effect of the amendments to those sections was to broaden their scope. As will be apparent, there are several important textual differences between the old versions of sections 110-25(5) and 110-55(2) (as well as sections 160ZH(1)(c), (2)(c) and (3)(c) of the 1936 Act) and their new versions, including:

1. Under the current formulation, the test is based on the purpose of the expenditure or its intended effect. Under the old formulation, only purpose was relevant.
2. The requirement in the processor provisions that the expenditure must be 'reflected in the state or nature of the asset' at the disposal time has been removed from the current formulation.
3. Under the current formulation, capital expenditure incurred for the purpose or with the expected effect of preserving, as well as enhancing value, is covered. It was not covered under the predecessor provision. This means, for example, that costs incurred in opposing a nearby development that would adversely affect the value of a taxpayer's rental property now fall within the fourth element.[74]

As explained above, the Commissioner in Example 1 of TD 2004/2W concluded that a 50% shareholder would, in effect, be able to include only 50% of a capital contribution in the fourth element of cost base. For our part, we doubt the Commissioner's conclusion that only 50% of the contribution can be included in the fourth element of cost base and cost base under the current version of sections 110-25(5). Where a shareholder makes a contribution to share capital without receiving shares in return each and every dollar of the contribution has the effect of increasing the value of the shareholder's shareholding. Although there is not a corresponding increase in the value of the shareholder's shareholding where the shareholder is not the only shareholder – that is, the value is effectively shared between multiple parties – this does not mean that the effect is not to increase the

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the Australian Government that it has probably not been possible, whether before or after the changes in the Company Law Review Act 1998, to make a direct contribution to the share capital of a company registered in Australia without an issue of scrip. As the Tax Office cannot provide advice on questions of corporations law, taxpayers should consider seeking private legal advice in relation to this matter."

[74] Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No. 1) Bill 2006* at [2.141].

value of the shares. There is no requirement that the purpose or expected effect be matched by a corresponding increase in value. Indeed, the omission of the phrase 'reflected in the state or nature' at the time of disposal indicates that the actual effect of the contribution is irrelevant; what matters is its purpose or expected effect. The following example illustrates this point:

- Company A is owned by Shareholder A (50%) and Shareholder B (50%)
- The shares in Company A are worth $100 – Shareholder A ($50) and Shareholder B ($50)
- Shareholder A makes a capital contribution to Company A without the issue of additional shares in Company A. The rights attaching to Shareholder A's shares are not varied to confer an exclusive entitlement to the capital contribution – in other words, each shareholder benefits from the additional capital contribution made by Shareholder A.
- The value of the shares in Company A increases to $200 – Shareholder A ($100) and Shareholder B ($100).

In the example above, the 'expected effect' of the capital contribution made by Shareholder A may be said to increase the value of the existing shares held by Shareholder A, even if the value of its existing shares is only increased by a portion (namely, $50) of the total capital contribution made by Shareholder A. The removal of the requirement under the fourth element that the expenditure be reflected in the 'state or nature' of the asset at the time of the CGT event supports this conclusion. As explained above, this appears to be consistent with the Commissioner's views expressed in the context of 'capital support payments' made by a parent to a subsidiary – including, a subsidiary which is not wholly owned – suggesting that the full amount of the capital contribution should be included in the fourth element of cost base and reduced cost base of the existing shares held by the parent in the subsidiary. It is also supported by at least one private ruling that the ATO has published where it accepted that the entirety of the amount of certain 'capital injections' paid to a company by a shareholder – who was one of three shareholders in the company, making equal contributions – should be included in the fourth element of the cost base of the shares held by that shareholder, under the current section 110-25(5).[75] This private ruling appears to have been published in August 2009 which was shortly before the withdrawal of TD 2004/2 (January 2010). A further private ruling was published in June 2016 in which the ATO ruled on a similar basis; in that case, while there is some suggestion that the capital injections were made by a shareholder who was not the sole shareholder of the company, that is not expressly stated in the ruling.[76]

In any event, even if this is wrong, and it is correct to adopt the Commissioner's previous approach in TD 2004/2 under which 50% of Shareholder A's capital contribution should be included in the cost base of the shares, the balance of $50 may be deductible under section 40-880 of the 1997 Act.

[75] PBR 91191. One obvious distinction is that the PBR involved each shareholder making proportionate contributions. In the PBR, the Commissioner also noted that, the capital injection was unlikely to be a 'non-scrip share capital contribution', as it was probable that non-scrip share capital contributions are **not** legal under Australian law (referring to the discussion in TD 2004/2 (see above). The Commissioner also said that the most plausible view as to the nature of the capital injection was that it was akin to a 'gift' to the company – according to the Commissioner, this was supported by concerns of breaching section 588 of the *Corporations Act* (which imposes a duty on directors to prevent a company trading when insolvent or to prevent a company becoming insolvent by incurring a debt), however, this would appear to be contrary to the findings in *Aurizon*. Finally, as the capital injection could be taken into account in working out the amount of a capital gain or loss from a CGT event affecting the shares, the Commissioner concluded that no part of the capital injection was deductible under section 40-880 (subsection 40-880(5)(f)).

[76] PBR 1013042899348.

4. (Re)shaping the Demerger Landscape

4.1 Introduction

Parliament anticipated that the demerger tax relief (contained in Division 125 of the 1997 Act) would 'facilitate the demerging of entities by ensuring that tax considerations [were] not an impediment to restructuring a business" and, for emphasis, made that goal the express object of Division 125. Parliament's hopes were widely shared by industry. The Securities Institute of Australia, for example, predicted that Division 125 would 'unlock shareholder value and put Australian companies in a more favourable position to complete globally.'

And for around 15 years, the ATO administered the demerger rules in such a way so as to ensure that the ATO itself did not act as the impediment that parliament had so consciously chosen to eliminate. Although certain types of transactions were beyond the pale, the ATO, by and large, interpreted the rules to achieve their stated goal of facilitating demergers. Most relevantly, the ATO concluded that demerger relief was available even when the demerged group or the demerged entity was acquired by a third party just after the demerger — even if the acquisition was conditional on the demerger or, in one case, when the two were inter-conditional.

But things changed in 2018. In two sets of transactions — one completed, Unibail-Rodamco and Westfield, and one frustrated, Blackstone and AMA — the ATO reversed course and concluded that demerger relief was not available when the demerger group was acquired after the demerger and the demerger was conditional on the acquisition, or vice versa. And, in March 2019, the ATO reiterated and expanded on its views in TD 2019/D1. The draft determination was finalised in July 2020 as TD 2020/6 (the **Determination**). What are the ATO's view in the Determination? In short, that the term "restructuring" is sufficiently broad and malleable to encompass not only the demergers themselves, but also acquisitions of the demerger group or specific capital placements after the demerger that, broadly, are known, planned or intended to occur at the time of demerger.

Our paper *'The Demerger Journey – from facilitation to frustration'*, presented to the Tax Summit in 2020, contains an overview of the technical demerger relief conditions, a history of the ATO's evolving views on demerger-acquisition schemes, and a detailed explanation why we think the ATO's interpretation in the Determination is inconsistent with the long line of Australian and English cases that construe the related words "reconstruction" and "reorganisation", the evident (and express) object of the demerger tax rules, the context in which the term appears and the broader structure of the tax legislation. We don't intend to cover the same ground here; our focus here is, instead, how the demerger landscape has changed since the publication of the Determination.

4.2 ATO's New Approach to Demergers – the Tax Determination

On 20 March 2019, the Commissioner published Taxation Determination TD 2020/6 'Income Tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the *Income Tax Assessment Act 1997*?' (the ***Determination***) (he had originally published the Determination in draft in March 2019).

4.2.1 What is a 'restructuring'?

The ATO's core assertion in the Determination is that the term 'restructuring' in subsection 125-70(1) should be interpreted according to its 'ordinary business meaning' and may include 'previous or subsequent transactions in a sequence of transactions.'

The Commissioner states at paragraphs 2 and 3 of the Determination:

> 2. In subsection 125-70(1), a 'restructuring' of the demerger group has its ordinary business meaning. It refers to the reorganisation of a group of companies or trusts. What constitutes a particular restructuring is essentially a

> question of fact. **However, all the steps which occur under a single plan of reorganisation will usually constitute the restructuring. The restructuring of a demerger group is not necessarily confined to the steps or transactions under paragraph 125-70(1)(b) that deliver the ownership interests in an entity to the owners of the head entity of the demerger group, but may include previous and/or subsequent transactions in a sequence of transactions.** Commercial understanding and the objectively inferred plan for reorganisation will determine which steps or transactions form part of the restructuring of the demerger group.
>
> 3. Transactions which are to occur under a plan for the reorganisation of the demerger group **may constitute parts of the restructuring of the demerger group** even though those transactions are legally independent of each other, contingent on different events, or may not all occur. For example, if a transaction or step is subject to a separate decision-making process (such as separate votes by shareholders of the company that is the head entity of the demerger group) from the steps taken to separate an entity, it may still be part of the restructuring. Thus the planned transfer of interests in the separated entity by all the owners of those interests to a particular acquiring entity would generally be considered to form part of the restructuring where commercially the transfer of the interests would be understood to be a step in a plan for the owners to transfer their interests in the separated entity to the acquiring entity. (emphasis and underlining added)

Note two things about this passage:

- First, the ATO interprets the term 'restructuring' to encompass related transactions – that is, it does not contend that those related transactions mean that the demerger is not a restructuring, only that the restructuring is broader than the demerger.
- Second, the ATO uses words and phrases in this passage and the balance of the Determination like 'plan', 'connected plan', 'planned transfer', 'step in a plan' and 'sequence of transactions.' These are concepts borrowed from tax integrity provisions and decisions, Australian and foreign, interpreting them.

In the Determination, the Commissioner also makes the following key points:

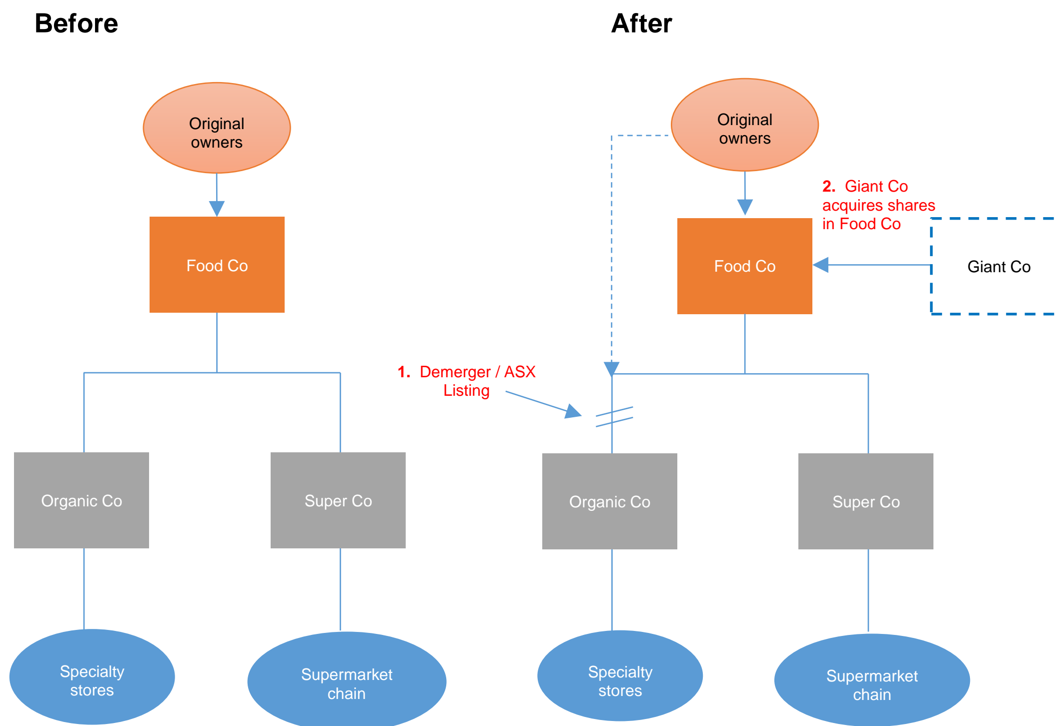
- the events described in subsection 125-70(1)(b) (the 80% condition) and subsection 125-70(1)(c) (the nothing else condition) may not, of themselves, constitute the entire scope of the restructuring because, in the Commissioner's view, those are conditions which must be satisfied 'under' the restructuring;[77]
- the scope of the restructuring is also relevant to the proportionality tests (in subsection 125-70(2)) because they are tested by reference to what occurs 'under a demerger';[78]
- the statutory intention for demerger relief is that it should only be available where 'the economic position' of the original owners remains the same before and after the restructuring;[79]
- the assessment of whether there has been a change to the economic position of the original owners should be tested by considering 'events, acts or transactions' occurring before or after the delivery of the ownership interests to the original owners;[80] and
- this interpretation best achieves the purpose of Division 125 because it ensures that a restructuring that does not result in a change in the economic position of the original owners will qualify for demerger relief.[81]

[77] Taxation Determination TD 2020/6 [50].
[78] Taxation Determination TD 2020/6 [53].
[79] Taxation Determination TD 2020/6 [51].
[80] Taxation Determination TD 2020/6[55].
[81] Taxation Determination TD 2020/6 [70].

4.2.2 Illustrative examples

In the Determination, the Commissioner provides six illustrative examples, including on post-separation capital raising and sale facilities. We focus on the examples related to demerger-acquisition schemes below.

Example 3 – sale of head entity after the separation of a subsidiary



- Food Co proposes to separate Organic Co by making an in specie distribution to Food Co shareholders of the shares in Organic Co, and listing Organic Co shares on the ASX.
- The separation is part of a plan to prepare for the sale of Food Co to Giant Co, and is a condition precedent to a sale of the shares in Food Co to Giant Co (but not vice versa – that is, the demerger is not conditional on the acquisition).
- The Commissioner concludes that the sale of Food Co forms part of a connected plan to separate Organic Co, and **would** form part of the 'restructuring' – even though the demerger could occur without the acquisition occurring. Why? Again, it appears to be based on an objective assessment or prediction about whether the demerger would actually have proceeded. Says the ATO: 'It is can be objectively inferred that the in specie distribution of Organic Co shares will occur in preparation for the Giant Co takeover proposal.'
- On that basis, the 'nothing else condition' **would not** be satisfied. (Interestingly, the Commissioner in the draft Determination concluded that the proportionality requirements would also not be satisfied in this case; in the final Determination, however, the Commissioner omits any reference to the proportionality requirements).

Example 4 – sale of head entity after the separation of a subsidiary

- Same facts as Example 3, **except** discussions with Giant Co terminate and 8 months later, after implementation of the separation, Mid Co announces that it will acquire the shares in Food Co.
- The Commissioner concludes that the Mid Co takeover bid is legally and commercially independent of the separation, and therefore, **will not** form part of the 'restructuring.'

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4.2.3 Applying the Tax Determination: Demerger-Acquisition Schemes

Since the Commissioner finalised the Determination in 22 July 2020, he has consistently denied relief to demerger acquisition schemes:

- On 29 July 2020, the ATO denied demerger relief to shareholders of TPG Telecom Limited, where it demerged Tuas Ltd subsidiary (Singapore Co), and subsequent to the demerger, was acquired by Vodafone Hutchison Australia Pty Limited.[82] The demerger was conditional on the acquisition.
- In 2021, the ATO denied demerger relief to shareholders of Cassini Resources Limited, where it demerged Caspin Resources Limited, and subsequent to the demerger, was acquired by OZ Minerals Limited.[83] The demerger and acquisition schemes were inter-conditional.
- In 2022, the ATO denied demerger relief to shareholders of Minotaur Exploration Ltd (***Minotaur***) where Minotaur demerged Demetallica Limited (***Demetallica***) prior to the acquisition of shares in Minotaur by Andromeda Metals Limited (***Andromeda***).[84] According to the Commissioner, the restructuring of the demerger group (of which Minotaur was the head entity) included both the reduction of share capital by Minotaur (under which shareholders acquired shares in Demetallica) and the acquisition of Minotaur shares by Andromeda (under which shareholders acquired shares in Andromeda). This meant that the 'nothing else' condition in paragraph 125-70(1)(c) was not satisfied. The demerger and acquisition schemes were inter-conditional.
- In 2022, the ATO denied demerger relief to shareholders of Firefly Resources Limited (***Firefly***) where Firefly demerged Firetail Resources Limited (***Firetail***) prior to the acquisition of shares in Firefly by Gascoyne Resources Limited (***Gascoyne***). According to the Commissioner, this is because Firefly shareholders also received Gascoyne shares under the 'restructuring' of the demerger group such that the 'nothing else' condition in paragraph 125-70(1)(c) was not satisfied. The demerger was conditional on the acquisition.

4.3 Applying the Tax Determination: 'Restructuring' Transactions after Demergers

Before the Determination was finalised, the ATO had, at various stages, adopted an unfavourable view of other transactions related to demergers, including schemes in which an acquisition of shares *precedes* the demerger. For example, in 2007 the ATO concluded that the acquisition of Publishing and Broadcasting Limited by Crown Limited and the subsequent demerger of PBL was part of the same restructuring and therefore ineligible for relief under Division 125.[85] In that scheme, the shareholders in PBL disposed of their shares to a newly incorporated entity, Crown Limited, for cash and shares in Crown.[86] The shareholders then, as new shareholders in Crown, received an in-specie distribution from Crown of shares in Consolidated Media Holdings Limited. The Commissioner ruled that demerger relief was not available for the in-specie distribution because:

- the restructuring included the earlier acquisition; and
- accordingly, the relevant demerger group was the group as it stood prior to the incorporation of Crown, i.e. the PBL group prior to its acquisition by Crown, and therefore Crown was not the head entity of the demerger group.

[82] See Class Ruling CR 2020/41.
[83] See Class Ruling CR 2021/49.
[84] Class Ruling 2022/61 [1].
[85] Class Ruling 2007/111.
[86] Class Ruling CR 2007/111.

Similarly, in 2018, the ATO denied demerger relief to shareholders in Eneabba Gas Limited.[87] Under the Eneabba Gas scheme, UIL Energy Ltd acquired certain entities owned by Eneabba Gas in exchange for issuing certain convertible redeemable preference shares to Enneaba Gas. Eneabba Gas subsequently made a pro rata in specie distribution of the CRPS in UIL to its shareholders. The ATO ruled that demerger relief was not available for the distribution because:

- the initial acquisition by UIL was part of the same 'restructuring' as the distribution; and
- accordingly, the relevant demerger group was the group as it stood prior to the acquisition by UIL, at which time UIL was not a member of the demerger group.

As a result of the finalisation of the Determination, and in particular confirmation of the Commissioner's view of the scope of the term 'restructuring', we expect the Commissioner to adopt the same position on analogous transactions in the future. This is supported by his approach to the recent BHP and Woodside demerger:

- Class Ruling CR 2022/60 sets out the income tax consequences for shareholders of BHP Group Limited (***BHP***) who received a dividend by way of an in specie distribution of shares in Woodside Energy Group Ltd (***Woodside***) on 1 June 2022.[88]
- BHP and Woodside entered into a share sale agreement on 22 November 2021, under which Woodside would acquire 100% of the share capital of BHP Petroleum in exchange for Woodside issuing new shares to BHP comprising approximately 48% of all Woodside shares.
- BHP agreed to then immediately distribute the newly issued Woodside shares to all BHP shareholders as an in specie fully franked dividend (***Special Dividend***).[89] To facilitate the specie distribution of Woodside shares, BHP resolved to pay the Special Dividend on 20 May 2022,[90] and exchanged all its shares in BHP Petroleum in exchange for Woodside shares, following which BHP transferred the Woodside shares to BHP shareholders as the Special Dividend on 1 June 2022.[91] The payment of the Special Dividend was debited against BHP's retained earnings and no part was debited to its share capital account.[92]

According to the Class Ruling, demerger relief was **not** available as Woodside was not a 'demerger subsidiary' of BHP when the restructuring commenced. According to the Commissioner, this was because:

- the definition of a demerger under subsections 125-70(1) and 125-65(1) of the 1997 Act requires that there must be a demerger group to which the restructuring happens in existence before the restructuring commenced;[93]
- in accordance with the views expressed in the Determination, the disposal of BHP's shares in BHP Petroleum for shares in Woodside and the distribution of those Woodside shares to BHP shareholders occurred under a single 'restructuring' for the purposes of the definition in subsection 125-70(1); and
- accordingly, the 'demerger group' to which the restructuring happened was the one that existed *before* the merger of Woodside and BHP Petroleum.[94] Based on that construction, at that time, Woodside was not a member of the demerger group.[95]

[87] Class Ruling CR 2018/7.
[88] Class Ruling 2022/60 [1].
[89] Class Ruling 2022/60 [28].
[90] Class Ruling 2022/60 [29].
[91] Class Ruling 2022/60 [33].
[92] Class Ruling 2022/60 [34].
[93] Class Ruling 2022/60 [38].
[94] Class Ruling 2022/60 [39].
[95] Ibid.

4.4 Board of Taxation – Review of CGT Roll-Overs

4.4.1 Introduction

The Board of Taxation conducted a review of the CGT roll-over rules and released a Consultation Paper in December 2020. The Board provided interim written advice to the Government on 25 March 2021. According to the Board's most recent update, it was expecting to submit a final report to the Government by the end of August 2022.[96]

In the context of demerger transactions, the Board of Taxation reported that:

- initial third party consultations indicated that the current law is 'unnecessarily constraining in the way it puts roll-over relief at risk when capital market transactions are known, planned or intended to occur in concert with the demerger resulting in significant uncertainty' (we agree);[97]
- stakeholders regard the law as applied by the ATO (in accordance with the Determination) as 'encroaching too far into commercial decision making' (we agree);[98]
- in relation to capital raising, in the absence of a preceding demerger, a company is free to raise equity finance without triggering CGT, however, if a capital raising follows a demerger, there is a risk that demerger relief will not be available, producing a clearly inconsistent result.[99] According to the Board, this is especially critical given decisions concerning the capital structure of demerged subsidiaries are often made at the same time as the demerger. The Board also noted that in obtaining demerger relief, one of the main commercial benefits sought is improving access to equity finance to enable demerged entities and subsidiaries to realise growth potential (we agree).

In the Consultation Paper, the Board of Taxation proposed a general roll-over for 'business restructuring' which is intended to replace the existing suite of transaction-based restructure roll-overs.[100] In particular, the proposed general business restructure roll-over is intended to incorporate and replace two broad categories of roll-overs:

- **Underlying assets-for-scrip**: roll-overs that apply when business assets are transferred to a company and the underlying ownership of the assets are maintained, such as Subdivisions 122-A, 122-B, 124-N and 126-B.
- **Scrip-for-scrip**: roll-overs that apply when scrip is exchanged for scrip resulting in new legal owner(s) holding at least 80% of an entity. The economic ownership of the underlying assets may not need to be maintained in certain circumstances. Roll-overs in this category include Divisions 125, 615 and Subdivision 124-M.[101]

4.4.2 Dealing with demergers and related transactions

Under the new 'general business restructure roll-over', CGT roll-over relief would be available for CGT events occurring in connection with a collection of transactions that constitute a single 'restructure' scheme. For example, a pre-ordained sale of replacement interests that follow a roll-over could form part of a single restructure scheme.

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[96] See, the Board of Taxation CEO Update, August 2022, available here: CEO Update - August 2022 (taxboard.gov.au).
[97] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 44.
[98] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 44.
[99] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 44.
[100] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 8.
[101] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 26.

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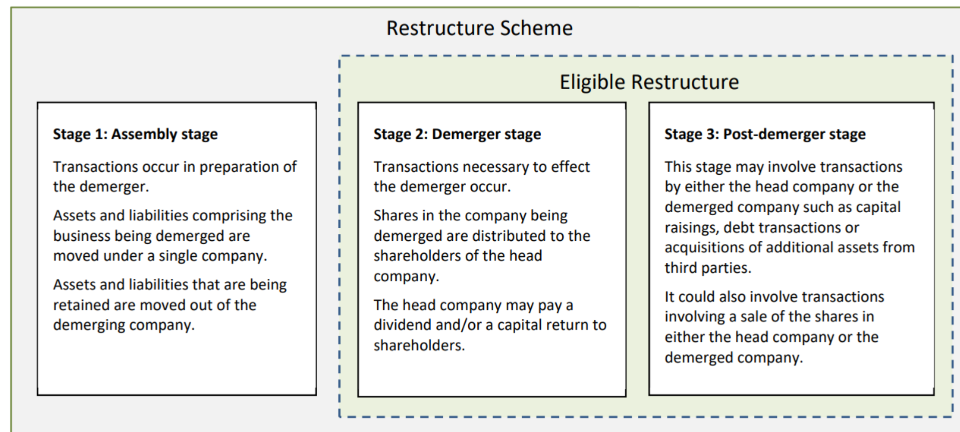
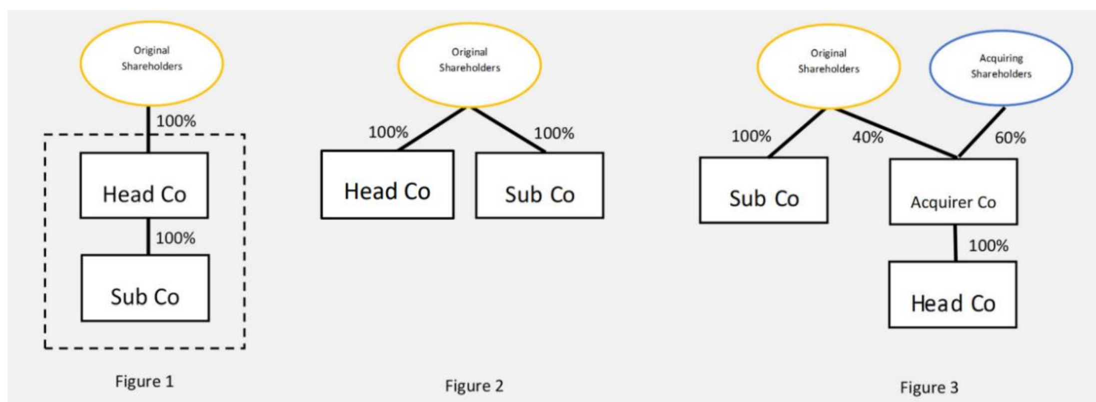
More specifically, in the context of demergers, the Board suggests that the eligible 'restructure' scheme could be defined by reference to the three usual phases for undertaking a demerger transaction – namely, Stage 1 (Assembly Stage), Stage 2 (Demerger Stage) and Phase 3 (Post-Demerger Phase):[102]

Figure 1: Example of three stage demerger transaction where stage 1 is excluded from the eligible restructure



Based on the above, therefore, transactions which occur following a demerger transaction – namely, transactions involving a capital raising by the head company or the demerged company, or a sale of shares in the head company or demerged company – would be eligible to qualify as part of the same 'restructure' scheme. This is confirmed by Example 2 (Back-to-Back Merger – Public Entity) of the Consultation Paper. In that example:

- Head Co is a listed public company.
- Acquirer Co seeks to acquire Head Co's business but does not want to acquire its real property assets.
- Head Co transfers all of its real property assets to Sub Co (a wholly owned subsidiary, and a member of the Head Co tax consolidated group).
- Head Co demergers Sub Co to its shareholders – under the demerger, shareholders receive 1 Sub Co share for every 5 Head Co shares.
- Following the demerger of Sub Co, Acquirer Co acquires all of the shares in Head Co and shareholders receive 0.4 new shares in Acquirer Co for each share previously held in Head Co.



[102] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 21. Note, in the diagram, the head entity and demerging entity are assumed **not** to be consolidated for tax purposes meaning that Stage 1 would need to be excluded from the 'restructure' scheme – one condition to the proposed general roll-over is that the restructure should not involve the transfer of CGT assets between members of a consolidatable group.

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According to the Consultation Paper, under the new general business restructure roll-over, the capital gain or loss from the demerger of Sub Co **and** the disposal of shares in Head Co would be disregarded.

One of the less desirable aspects of the new general business restructure roll-over is the proposed modifications to the cost base rules. In particular, based on the model proposed by the Board, the cost base of the ownership interests acquired by the acquiring entity would be constructed by reference to the cost bases of the underlying assets of the target entity rather than the market value of the ownership interests acquired by the acquiring entity. The model proposes (as a uniform rule) employing a cost base 'push up' method of calculating the cost base of the ownership interests acquired by the acquiring entity similar to the cost base rules currently set out in Division 615 and the restructure provisions of the scrip-for-scrip rollover in section 124-784B.[103]

Based on this approach, to continue the example above, the cost base of the Head Co shares acquired by Acquirer Co would, broadly, be calculated by reference to the historical cost base of the assets of Hold Co less its liabilities. This would be different to the basis on which the cost base of the Head Co shares would be calculated under the current scrip for scrip roll-over rules in Subdivision 124-M – under those rules, assuming there is no 'significant stakeholder', Acquirer Co should be entitled to recognise a cost base equal to the market value of the Hold Co shares acquired.

[103] Board of Taxation, *Review of CGT Roll-overs* (Consultation Paper, December 2020) 32.

5. Special dividends – some tips and traps

5.1 Introduction

The payment of a 'special dividend' by a target company in connection with a scheme of arrangement is a common feature of public takeover transactions in Australia.

A scheme will often allow a target to pay a special dividend to target shareholders, in order to improve the purchaser's offer by allowing qualifying Australian tax resident shareholders to get the benefit of franking credits in the target (subject to an ATO class ruling). Typically, then, the target company will attach franking credits to the special dividend so that it is fully or partly franked.

The special dividend will typically be conditional on the scheme becoming effective, and the cash or scrip consideration under the scheme is usually (but not always) reduced by the face value of the special dividend. The target will need sufficient profits or retained earnings to pay the dividend, and would also need to consider the balance sheet test, and the financial assistance prohibition under the *Corporations Act*.

The two key tax issues that arise where a franked special dividend is paid in connection with a scheme are:

- First, does the special dividend form part of the 'capital proceeds' received by a shareholder for the disposal of their shares in the target company?

- And second, do the franking credits attaching to the special dividend pass to target shareholders?

As explained below, we focus here not on the technical issues associated with these questions – which have been discussed in detail in other papers – but on the ATO's practical approach to them. Our discussion below is based on our analysis of the ATO's position on all (publicly available) special dividends declared or paid in connection with a scheme of arrangement in the previous 8 years.

The following diagram maps out some of the key issues which are discussed in more detail below.[104]

[104] This diagram does not, and is not intended to, canvass all the tax issues which would need to be considered in this context, but rather is offered as a high level road map of certain threshold issues only – by way of example, where a special dividend is paid in connection with a scheme of arrangement, various tax integrity rules, including, the rule in section 177EA, would also need to be considered and a ruling would typically obtained from the ATO confirming that the Commissioner would not exercise his discretion to apply section 177EA to the special dividend. This paper does not consider the scope of those integrity rules, except as otherwise discussed in Section 1 above.

5.2 Some key practical takeaways

Does the special dividend form part of capital proceeds?

Does the purchaser participate in the payment of the special dividend?

Is the implementation (or effectiveness) of the scheme conditioned on any of the following:

1. the declaration (or determination) or payment of a special dividend;
2. the purchaser (or a third party) funding the special dividend; or
3. otherwise subject to the purchaser (or a third party) ensuring the dividend will be declared (determined) or paid?

No → **Special dividend unlikely to be included in capital proceeds**

Yes → **Special dividend likely included in capital proceeds**

Tax Treatment of Special Dividends

Do franking credits pass to target shareholders?

Is there a **related payment**?

1. Is the scheme consideration reduced by the face value of the special dividend?
2. Is declaration or payment of the dividend contingent on the scheme being effective or implemented?

No → 'Holding period' rule must be satisfied for the **'primary qualification period'**

Yes → 'Holding period' rule must be satisfied for the **'secondary qualification period'** → **The 'ex-dividend' date – the day after the special dividend record date – should be at least one day prior to the scheme record date**

Is the special dividend directly or indirectly funded by a capital raising (by *any* entity)? Potential impact of proposed new tax integrity rule should be considered

Is the purchaser effectively wholly owned by foreign or tax exempt entities?

Yes → Is the special dividend paid **after** the scheme record date and before the implementation date?

- No → **Company should not be an 'exempting entity' – assuming the company is not otherwise effectively owned as to 95% or more by foreign residents – although ATO position not clear**
- Yes → **Consider if risks of loss and opportunities for gain in respect of the shares has passed to purchaser**

No → **Company should not be an 'exempting entity', assuming the company is not otherwise effectively owned as to 95% or more by foreign residents**

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5.3 Does the special dividend form part of capital proceeds?

Section 116-20 of the 1997 Act states that the 'capital proceeds' from the disposal of a CGT asset (eg, shares in a company) is the total of:

(a) the money received, or entitled to be received, in respect of the event happening; and

(b) the market value of any other property received or entitled to be received in respect of the event happening (worked out as at the time of the event).

In Taxation Ruling TR 2010/4 (***TR 2010/4***), the Commissioner outlines the circumstances in which he considers that a pre-sale dividend would likely constitute capital proceeds from a disposal of shares under a contract or a scheme of arrangement. In particular, paragraph 9 of TR 2010/4 states that:

> A dividend declared or paid by the target company to the vendor shareholder will be money or property that the vendor shareholder has received, or is entitled to receive, under the contract or the scheme of arrangement, in respect of the transfer of the shares, if the vendor shareholder has bargained for the receipt of the dividend (whether or not in addition to other consideration) in return for giving up the shares. That is to say, if the dividend forms the whole or part of that sum of money or property in return for which the vendor shareholder is willing, and under the contract has promised or under the scheme of arrangement is bound, to transfer the shares in the target company, it will be capital proceeds in respect of the CGT event A1 happening.

We do not discuss here the asserted basis for the Commissioner's views and their soundness. They have been comprehensively canvassed in other papers.[105] Instead, we focus on how the ATO has applied its views in practice in the context of special dividends paid in connection with schemes of arrangement. Based on our review of all class rulings published by the ATO in the previous 8 years, we have identified the following trends:

- in all cases where the target funded the special dividend from its existing cash or debt reserves, the Commissioner ruled that the special dividend did **not** form part of capital proceeds – the only exception was in the case of Folkestone Limited (CR 2018/51) where despite the target funding the special dividend, it was included in capital proceeds on the basis that the company was required to declare and pay the special dividend once the scheme was approved by shareholders;[106]

- in all cases where the purchaser agreed to fund the payment of the special dividend, the Commissioner ruled that the special dividend **did** form part of capital proceeds;[107]

- in most cases, the declaration and payment of the special dividend was conditional on the scheme being effective or implemented – in a small number of cases the special dividend was not conditional and in those cases the special dividend did **not** form part of capital proceeds[108] (and, in one case, the Commissioner did not rule on whether it formed part of capital proceeds but the tax disclosure in the scheme booklet appeared to proceed on the basis that it would **not**)[109]; and

- in the scheme involving Pepper Group Limited (CR 2018/21), the declaration or determination of the special dividend by the board was a condition precedent to the scheme becoming effective,[110] and the

[105] See, for example, David Wood, 'Mergers and acquisitions in financial services' (7-9 February 2018) presented at the 2018 Financial Services Conference.
[106] See CR 2018/51, paragraphs [20] and [120].
[107] See, for example, schemes involving Zenith Energy Limited (CR 2020/52) and AIRR Holdings Limited (CR 2019/74).
[108] See, for example, schemes involving Asaleo Care Limited (CR 2021/47), The Citadel Group Limited (CR 2021/31), QMS Media Limited (CR 2020/38) and Dulux Group Limited (CR 2019/51).
[109] See the scheme involving Coca-Cola Amit Limited (CR 2021/35).
[110] See clause 3.1(p) of the Scheme Implementation Deed (as amended by the Second Amending Deed dated 25 September 2017).

Commissioner ruled that the special dividend **did** form part of the capital proceeds received by shareholders for the disposal of their Pepper shares.

5.3.1 Consequences of special dividends forming part of capital proceeds

Generally speaking, if a special dividend forms part of the capital proceeds from the disposal of shares in a company, the amount of any capital loss that may otherwise be realised from the disposal is reduced. It may also affect the cost base of new shares acquired by a target shareholder for transactions where shares (rather than cash) are received as part of the scheme consideration and scrip for scrip rollover is available.

If a special dividend forms part of the capital proceeds from the sale of shares:

- any capital gain made by a shareholder may be reduced (but not below zero) by the amount of the special dividend that is included in the assessable income of the shareholder (eg, under section 44 of the 1936 Act) under the 'anti-overlap' rule in section 118-20;[111] **but**
- the anti-overlap rule in that section only applies to reduce a 'capital gain'; it does not apply to *increase* a capital loss. In other words, where a special dividend forms part of capital proceeds, it will reduce a capital loss that, apart from the dividend, a shareholder would have made from the disposal of the shares. According to the ATO, this is consistent with the 'scheme' of the 1997 Act which is to allow a capital loss resulting from the disposal of an asset to the extent that an 'actual loss' has been incurred.[112]

If a special dividend forms part of the capital proceeds from the sale of shares (the ***Target Shares***) and the scheme consideration comprises shares in the purchaser (or 'ultimate holding company' of the purchaser) (***Replacement Shares***), and CGT roll-over relief under Subdivision 124-M of the 1997 Act is available:

- a capital gain made by the shareholder should be disregarded to the extent that it is attributable to the Replacement Shares;[113]
- no roll-over should be available to the extent that the capital gain is attributable to the special dividend (the special dividend will be treated as 'ineligible proceeds');[114] and
- for the purpose of determining the CGT cost base and reduced cost base of the Replacement Shares, the cost base of the Target Shares will be reasonably apportioned between the Replacement Shares **but** must first be reduced by so much of it that is reasonably attributable to the special dividend.

In other words, where a special dividend is included in capital proceeds, the cost base of the Replacement Shares will be reduced by the portion of the cost base of the Target Shares that is reasonably attributable to the special dividend, meaning that the amount of the special dividend would effectively be subject to tax again on a subsequent disposal of the Replacement Shares.

This occurred in the scheme involving iiNet Limited (CR 2015/71) where the Commissioner ruled that the special dividend paid by the company formed part of the capital proceeds received by shareholders for the disposal of their iiNet shares on the basis that (A) the dividend would only be declared once the scheme became effective; and (B) TPG (the purchaser) agreed to fund the payment of the special dividend by way of an interest-free loan. For shareholders who elected the 'Share Consideration', the Commissioner ruled that only partial scrip-for-scrip roll-over would be available under Subdivision 124-M,[115] and required iiNet shareholders to calculate the cost base of each new TPG shares by reasonably attributing to it the cost base (or part of it) of the iiNet share for

[111] Taxation Ruling TR 2010/4 (paragraph 41).
[112] Taxation Ruling TR 2010/4 (paragraph 49).
[113] 1997 Act, section 124-790.
[114] 1997 Act, section 124-790.
[115] CR 2015/71, para 101.

which it was exchanged. The cost base of the iiNet share would first be reduced by so much of it that was reasonably attributable to the special dividend.

5.4 Frankability of the special dividend

5.4.1 Is the shareholder a 'qualified person'?

Subsection 207-145(1)(a) of the 1997 Act provides that, in relation to a franked distribution, an entity will only be entitled to a gross-up and franking offset if it is a 'qualified person' for the purposes of former Division 1A of Part IIIAA of the 1936 Act. In relation to a special dividend, therefore, scheme shareholders will only be 'qualified persons' if they have satisfied the 'holding period rule' and the 'related payments rule' under former Division 1A of Part IIIAA of the 1936 Act.

The 'holding period rule' requires shareholders to hold their shares, or an interest in shares, on which a dividend is paid 'at risk' for either the 'primary qualification period' or the 'secondary qualification period', depending on whether the shareholder is under an obligation to make a 'related payment' in relation to the dividend. To determine the relevant qualification period, it is necessary to consider whether, under a particular scheme, shareholders will be under an obligation to make a 'related payment'. Former subsection 160APHN(2) of the 1936 Act provides as follows:

> 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.

Former subsection 160APHN(3) of the 1936 Act provides a non-exhaustive list of examples of what constitutes the making of a related payment for the purposes of Division 1A of former Part IIIAA of the 1936 Act.

Based on the Commissioner's practice, if the special dividend **reduces** the amount of scheme consideration receivable by a shareholder for the disposal of their shares, it is likely that the payment of the special dividend will constitute a 'related payment' for the purposes of former 160APHN – this is because, based on the Commissioner's view, the benefit of the special dividend is said to be passed to the purchaser in the form of a reduced purchase price (where the price reduction exactly equates to the amount of the special dividend). The Commissioner's views are typically described in the following terms (CR 2022/75):

> 20. The Permitted Dividend constitutes a 'related payment' for the purposes of former section 160APHN of the ITAA 1936. **As the consideration paid by MBC for acquiring the Uniti shares was reduced by the amount of the Permitted Dividend, this reduction has the effect of passing the benefit of the Permitted Dividend from the shareholders of Uniti to MBC** (former subsection 160APHN(2), former paragraph 160APHN(3)(f) and former paragraphs 160APHN(4)(c) and (d) of the ITAA 1936). (emphasis added)
>
> 21. Therefore, you are taken to have made a related payment in respect of the Permitted Dividend.

This approach is not entirely free from doubt or controversy – the reduction to the scheme consideration is generally a function of the net assets of the target being reduced as a consequence of the payment of the special dividend rather than the benefit of the special dividend being 'passed' to the purchaser. Still, the Commissioner has generally insisted on this view.

Based on our review of all class rulings published by the ATO in the previous 8 years, the following key trends emerge concerning the Commissioner's analysis of the qualified person rules in the context of special dividends paid in connection with schemes of arrangement:

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- Where the scheme consideration is reduced by the amount of a special dividend, **and** is contingent on the scheme being effective or implemented, the Commissioner considers that a shareholder **would** make a related payment.

- Where the dividend is **not** contingent on the scheme even if it reduced the scheme consideration otherwise payable to the shareholder, the Commissioner considers that a shareholder would **not** make a related payment.[116]

- In most cases, the special dividend paid to shareholders reduced the amount of the scheme consideration, consistent with the principle above that the purpose of adjusting the scheme consideration is generally on account of the reduced net assets of the target. There are, however, some exceptions.[117] In those cases, the Commissioner ruled that the shareholder did **not** make a related payment; with the exception of CR 2018/21 (involving Pepper Group Limited), where the scheme was conditional on (A) shareholders approving an amendment to the constitution to permit the payment of the special dividend, and (B) the special dividend being declared or determined by the board – on that basis, the Commissioner ruled that the shareholders **would be** taken to make a related payment.

5.4.1.1 Where there is a 'related payment'

If a shareholder is taken to make a 'related payment' in respect of the special dividend, the shareholder would be required to hold their shares 'at risk' for a continuous period of at least 45 days during the **'secondary qualification' period** in order to be a 'qualified person' in respect of the special dividend. The secondary qualification period requires that the shareholder holds their share 'at risk' for a continuous period of at least 45 days during the period that:

- begins on the 45th day before; and

- ends on the 45th day after,

the day on which the shares become ex dividend. The 'ex-dividend' date is the day **after** the last day on which the acquisition by of a share will entitle the person to receive the dividend (ie, the 'Special Dividend Record Date').[118] When applying the secondary qualification period, a shareholder cannot count the day on which they acquired the share or the day on which they disposed of the share. Broadly, shareholders will be considered to hold their shares 'at-risk' on a particular day provided that they do not have 'materially diminished' risks of loss or opportunities for gain in respect of their shares, which they will be taken to have if the shareholder has less than 30% of the risks of loss and opportunities for gain from owning those shares.[119]

Based on our review of all class rulings published by the ATO in the previous 8 years, the Commissioner's uniform practice appears to be that a shareholder will be considered to no longer hold their shares ‘at risk’ for the purposes of former Division 1A of Part IIIAA of the 1936 Act on and from the **'Scheme Record Date'**: see, for example, the CR 2022/63 relating to Crestone Holdings Limited. The Commissioner's views are typically described in the following terms (CR 2022/75):

> 26. You had materially diminished risks of loss or opportunities for gain on and after the Scheme Record Date (28 July 2022), when you became committed to disposing of your shares in Uniti in exchange for the scheme consideration.

[116] See, for example, the interim dividend paid to shareholders of LifeHealthcare Group Limited (CR 2018/33) and the shareholders of Colorpak Limited (CR 2016/25)).
[117] See, for example, the schemes involving Asaleo Care Limited (CR 2021/47), Saracen Mineral Holdings Limited (CR 2021/38), Bellamy's Australia Limited (CR 2020/3) and Pepper Group Limited (CR 2018/21).
[118] Former section 160APHE of the 1936 Act
[119] Former subsection 160APHM(2) of the 1936 Act.

This means that, where there is a related payment, in order for the shareholder to be able to satisfy the secondary qualification period the 'ex-dividend' date (the day after the special dividend record date) must be **at least one** day prior to the scheme record date (see the timeline on the following page). Said another way, the scheme record date should be at least two days **after** the special dividend record date.

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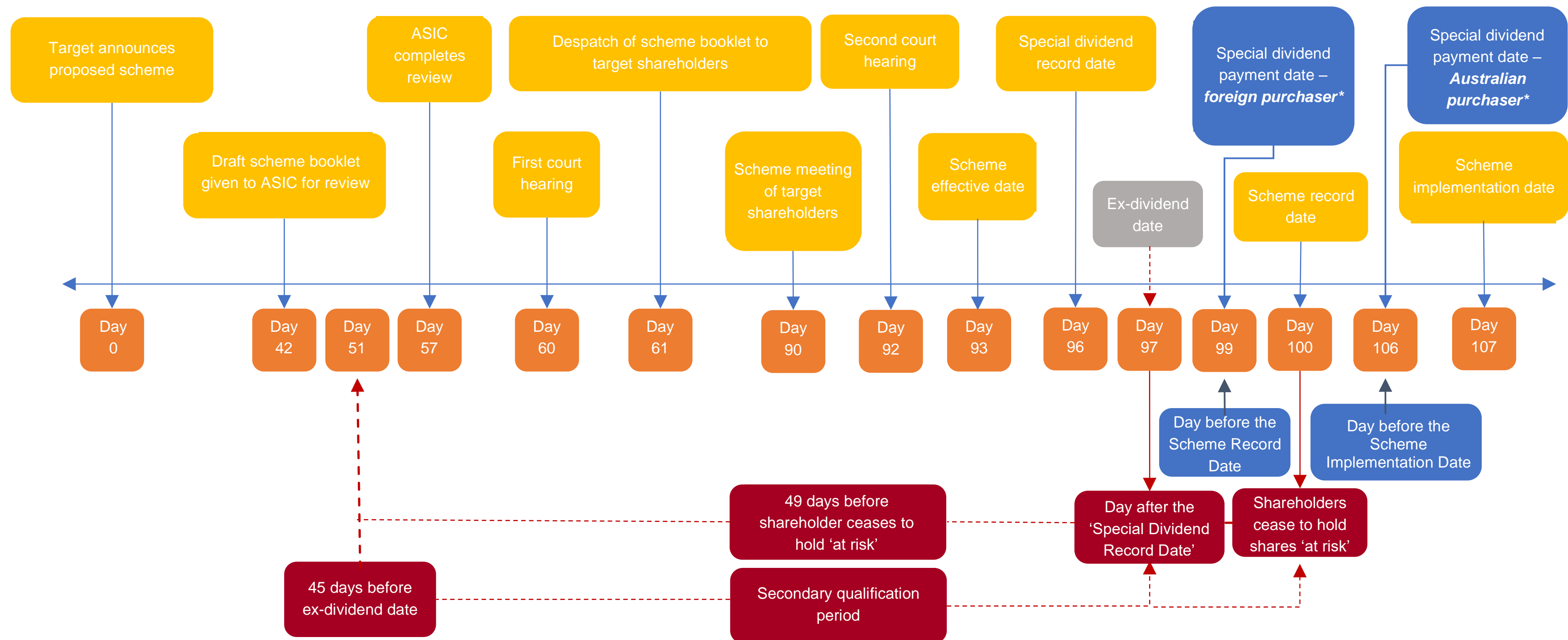
5.4.1.2 Indicative Scheme Timeline



5.4.1.3 Where there is no 'related payment'

Where a shareholder is **not** taken to make a related payment in relation to the special dividend, the shareholder will be required to hold their shares 'at risk' for a continuous period of at least 45 days during the 'primary qualification' period in order to be a 'qualified person' in respect of the special dividend. The primary qualification period requires that the shareholder holds their shares 'at risk' for a continuous period of at least 45 days during the period that:

- begins on the day **after** the date of acquisition of the share; and
- ends on the 45th day after the day on which the share becomes ex dividend.

As noted above, the 'ex-dividend' date should be the day after the last day on which the acquisition by a person of a share will entitle the person to receive the dividend (ie, the 'Special Dividend Record Date').[120]

5.4.2 Is the company an 'exempting entity'?

Where a company is an 'exempting entity', franking credits would generally (subject to certain limited exceptions) not be available to Australian resident shareholders. In particular, section 208-195 provides that Division 207 of the 1997 Act does **not** apply to a distribution by an exempting entity unless it is expressly stated to apply under Subdivision 208-G. Distributions paid by an exempting entity to non-resident shareholders may, however, carry the same entitlement to an exemption from dividend withholding tax as ordinary franked dividends.[121]

Section 208-20 states:

> A corporate tax entity is an exempting entity at a particular time if, at that time, the entity is 'effectively owned by prescribed persons'.

Under section 208-40, the definition of a 'prescribed person' in relation to another corporate tax entity includes companies, trustees, partnerships or individuals that are a foreign resident; or if they were to receive a distribution made by a corporate tax entity, the distribution would be exempt income or non-assessable non-exempt income of the company, trust estate, partnership or individual.

Broadly, subsection 208-25(1) provides that an entity is 'effectively owned by prescribed persons' if:

- not less than 95% of accountable membership interests or accountable partial interests (ie, direct and indirect ownership interests in the entity) are held by, or on behalf of, 'prescribed persons'; or
- it would be reasonable to conclude that the **risks and opportunities** resulting from holding accountable membership interests or accountable partial interests in the entity are **substantially borne by or substantially accrue to 'prescribed persons'**.

When applying the second test, the rules make it necessary to consider any *arrangement* in respect of membership interests (including unissued membership interests) in the entity, excluding risks borne by any person in their capacity as a secured creditor.[122]

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[120] Former section 160APHE of the 1936 Act

[121] See para 6.10 of the Explanatory Memorandum to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*.

[122] Subsection 208-25(2) of the 1997 Act.

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According to the Explanatory Memorandum to the *Taxation Laws Amendment Bill (No. 4) 1998*, the purpose of the second test is to ensure that arrangements which in economic substance amount to ownership of a company are covered by the rule:

> 5.20 Where for example, a non-resident owns 70% of an Australian company and an Australian resident owns the remaining 30%, if the Australian resident has transferred the risks and opportunities of ownership of the shares to the non-resident (eg. the resident has forward sold the 30% interest to the non-resident) the Australian company will still be an exempting company notwithstanding that nominally only 70% of the company is held by prescribed persons.
>
> 5.21 This test also has regard to unissued shares. This is to prevent the test being avoided by 'flooding allotments' of shares, under which existing shareholdings are diluted to an insignificant proportion by the issue of new shares. For example, if a resident owns two shares, which are the only issued shares, but under an arrangement (eg. an option over unissued shares) a prescribed person or persons will acquire 100 new shares to be issued in the future (which will be accountable shares) the effect may be to place effectively all the risks and opportunities of holding accountable shares into the hands of prescribed persons even though they currently hold no shares.

In the context of a scheme, where the purchaser is foreign owned or controlled, this raises an important threshold question: at what point in time is it reasonable to conclude that the risks and opportunities of the membership interests in the target company are substantially borne by, or substantially accrue to, the purchaser? The answer to that question would appear to principally turn on the position under the Corporations Act. Under section 411(4) of the Corporations Act, an arrangement between a company and its members will become binding on the parties if:

- it is approved by the requisite majorities at a court convened meeting of members; and
- it is approved by the court.

Under section 411(1), an order of the Court does not have any effect until a copy of the order is lodged with ASIC, and upon being so lodged, the order takes effect, or is taken to have taken effect, on and from the date of lodgement or such earlier date as the Court determines and specifies in the order.

Andrew Rich and Tony Damian in *Schemes, Takeovers and Himalayan Peaks* (4th ed), 187-188 describe the process in the following terms:

> A scheme of arrangement will not have any effect until a copy of the order of the Court made under s411 (4)(b) of the Corporations Act 2001 (Cth) approving the scheme is lodged with ASIC. Once the order is so lodged, the order will take effect, or will be taken to have taken effect, on the date of lodgement or on such earlier date determined by the Court and specified in the order. The date on which the scheme takes effect is colloquially referred to as the "effective date".
>
> The effective date will usually be either the date on which the Court makes its order approving the scheme or the next business day…
>
> If the securities in the target company are listed on the ASX, and the scheme involves a reorganisation of capital, a copy of the order of the Court must also be given to the ASX. In any event, an ASX-listed target company will be obliged by its continuous disclosure obligations to keep the market updated on the progress of the scheme of arrangement. These obligations will require it to, among other things, immediately announce the result of the final court hearing and the fact of the scheme becoming effective.
>
> After the Court's orders have been lodged with ASIC, the mechanical steps to give effect to the scheme (including the payment of the scheme consideration to target members and, in the case of a transfer scheme, the transfer of the shares to the bidder (other than those held by the bidder) or, in the case of a cancellation scheme, the cancellation of all the shares in the target (other than those held by the bidder)) are carried out on a nominated "implementation date". The implementation date is a specified number of days (usually the fifth business day) after the "record date"; however, it can be as short as four calendar days after the record date.

> The record date is simply the date on which the identity of target members who are to participate in the scheme (that is, who are to receive the scheme consideration and to either have their shares transferred to the bidder (in the case of a transfer scheme) or have their shares cancelled (in the case of a cancellation scheme)) is determined. The ASX Listing Rules require the record date to be the fifth business day after the date on which the scheme becomes effective. Trading in the target shares on the ASX will cease at close of business on the effective date.

Where there is a foreign owned or controlled purchaser, the target company would obviously become an 'exempting entity' for the purposes of subsection 208-25(1) at least by the Scheme Implementation Date; that is the date on which the legal title to the shares are transferred to the purchaser. But, do the risks and opportunities substantially pass to the purchaser under a scheme of arrangement **prior** to the time the 'mechanical steps to give effect to the scheme' are undertaken? Any special dividend would, of course, need to be paid prior to that time otherwise Australian resident shareholders may not be entitled to franking credits attached to the special dividend. As far as we are aware, there is no authority considering the meaning of this phrase 'effectively owned by prescribed persons' in this context.

In analysing the question, it is important to remember that the bidder is not a party to the scheme of arrangement:

> The "scheme itself' is the document which records the terms and conditions of the proposed arrangement between the target and its members (or class of members, where there is more than one class). The members (or the class of members, as the case may be) are required to agree to the terms of this document. Following such agreement being obtained, the Court will be asked to approve the terms of this document. The terms and conditions of the scheme itself will usually be negotiated between the prospective bidder.[123]

Instead, under the 'deed poll', the bidder undertakes to the target shareholders to perform its obligations to pay the consideration to the target shareholders:

> The Courts will not approve a scheme of arrangement unless they are satisfied that any third party (such as the bidder) who is necessary to the implementation of the scheme of arrangement has effectively bound itself to take all steps necessary on its part to implement the scheme.
>
> In the case of schemes of arrangement which are used to effect change of control transactions in Australia, the mechanism through which the bidder binds itself to the implementation of the scheme is through the execution by it of a deed poll. The deed poll contains an undertaking by the bidder, in favour of the target members (or the relevant class or members, if there is more than one class), to perform the obligations the obligations attributed to it in the scheme itself (and the other matters stated in the scheme itself to be done by it) under the scheme and in relation to the implementation of the scheme, including the provision of the scheme consideration to target members if the scheme is approved. **The deed poll thus gives target members a direct contractual right against the bidder in the event that the bidder fails to perform its obligation to provide the scheme consideration to the target members in exchange for the surrender of their shares in the target upon the implementation of the scheme.**
>
> Like the terms of the scheme itself, the terms of the deed poll will usually be negotiated between the prospective bidder and target at the same time as the merger implementation agreement is being negotiated.[124]

In other words, it would appear that the target shareholders would have a 'direct contractual right' against the bidder to require the bidder to perform its obligations to provide the scheme consideration to the target members in exchange for the transfer of the shares to the bidder. **But** the bidder does not appear to have a corresponding right to enforce the scheme against the target shareholders; instead, the bidder's contractual rights to enforce implementation of the scheme appear to be limited to those created under the scheme implementation deed or agreement and enforceable against the target.

Two possible alternative dates on which the bidder becomes the 'effective owner' for the purposes of the exempting entity rules appear to be:

[123] Andrew Rich and Tony Damian in *Schemes, Takeovers and Himalayan Peaks* (4th ed), 244.
[124] Andrew Rich and Tony Damian in *Schemes, Takeovers and Himalayan Peaks* (4th ed), 244-245.

- First, the **'Scheme Effective Date'** – the date that court orders approving the scheme are lodged with ASIC, and trading in the target shares on the ASX ceases; and
- Second, the **'Scheme Record Date'** – the date on which the identity of target members who are to participate in the scheme is determined, being the fifth business day after the Scheme Effective Date (to allow sufficient time for transfers of securities to be effected).

We understand that the ATO has more recently expressed the view that an Australian listed company would become an 'exempting entity' for the purposes of section 208-25 on the Scheme Record Date (or potentially, the Scheme Effective Date) in connection with a scheme involving a purchaser which was a wholly-owned (Australian tax resident) subsidiary of a foreign parent. Based on the Commissioner's uniform practice of treating a shareholder as no longer holding their target shares 'at risk' on and from the Scheme Record Date for the purposes of the 45 day rule (see above), that date appears to be the more likely possibility (than the Scheme Effective Date) in this context.

As far as we're aware, the ATO's position has not been confirmed in any public or private ruling. Instead, this particular view was expressed in 2019 during the course of negotiating a class ruling. In that case, we understand the special dividend was proposed to be paid (and was, in fact, paid) after the Scheme Record Date. We also understand that the practical solution reached with the ATO in that case was that the class ruling would confirm Australian resident shareholders would be entitled to franking credits attaching to the special dividend, but the ATO would **not** make any ruling on the whether the target was an 'exempting entity'.

Based on our review of class rulings published over the last 8 years (see the table below), this practice seems to have been (almost) uniformly adopted by the ATO. In particular:

- Subject to the two exceptions noted below, for schemes which involved a foreign owned or controlled purchaser, where the Special Dividend Payment Date was **after** the Scheme Record Date, the ATO has **not** ruled on whether the target company was an 'exempting entity' (or former exempting entity).
- Where the Special Dividend Payment Date was **before** the Scheme Record Date, there have been multiple occasions on which the ATO have ruled that the target company is not an exempting entity.[125]
- In two schemes involving a foreign owned or controlled purchaser, the Special Dividend Payment Date was **before** the Scheme Record Date, the ATO also did **not** rule on whether the target company was an 'exempting entity' (or former exempting entity) in those cases. In particular, in the 2016 scheme involving Asciano Limited, the Special Dividend Payment Date (11 August 2016) was prior to the Scheme Record Date (12 August 2016), and in the 2017 scheme involving Programmed Maintenance Services Limited, the Special Dividend Payment Date (20 October 2017) was prior the Scheme Record Date (23 October 2017), but the ATO did not rule on whether the company was an exempting entity in either case. It is possible that the taxpayer did not invite the Commissioner to rule on this point, or that the Commissioner took the view that the taxpayer was an exempting entity on the Scheme Effective Date (rather than the Scheme Record Date) and declined to rule on that basis.

There are two exceptions to this trend:

- First, the 2019 Villa World Limited scheme of arrangement where the Special Dividend was paid on 28 October 2019, which was **after** the Scheme Record Date (23 October 2019). AVID Property Group Australia Pty Limited, the acquirer in that case, was an entity that was owned by a "number of international institutional investors".[126]

[125] See, eg, CR 2022/11 (Huon Aquaculture Group Limited), CR 2022/01 (rhipe Limited) and CR 2021/47 (Asaleo Care Limited).
[126] See page 44 of the Scheme Booklet.

- Second, the 2019 RuralCo Holdings Limited scheme of arrangement where the Special Dividend was paid on 30 September, which was **after** the Scheme Record Date (23 September 2019). Agrium Australia Pty Ltd, the acquirer in that case, was an entity that was wholly owned by Nutrien Limited (a Canadian company listed on the Toronto Stock Exchange and New York Stock Exchange).[127]

In Class Ruling CR 2019/71, the Commissioner stated that:

> 97. Villa World was not an exempting entity at the time the Special Dividend was paid to Villa World's shareholders, nor was it a former exempting entity at that time, as less than 95% of the accountable membership interests or accountable partial interests held in Villa World were held by foreign residents (Division 208).

The Commissioner made a similar ruling in Class Ruling CR 2019/64 for the RuralCo scheme.

But both Class Rulings were published before the time at which we understand the ATO expressed its views in 2019 in the course of negotiating the class ruling. It is also interesting to note that the Commissioner in the Class Rulings did not make any express reference to the second limb of the exempting entity test; in contrast, see the recent Class Ruling for the 1300 Smiles Limited scheme (CR 2022/4):

> 87. Paragraph 208-25(1)(b) provides that 1300 Smiles would be effectively owned by prescribed persons at a particular time if it is reasonable to conclude that, at that time, the risks involved in, and opportunities resulting from, the membership interests in 1300 Smiles not held by prescribed persons were nevertheless substantially borne by, or accrued to, prescribed persons.
>
> 88. As the risks and opportunities associated with those membership interests will be retained by Australian residents, 1300 Smiles was not effectively owned by prescribed persons at the time the Special Dividend was paid.

Since the scheme of arrangement involving Bellamy's Australia Limited (2020; CR 2020/3), we are not aware of a scheme involving a foreign owned or controlled purchaser where the Special Dividend Payment Date was **after** the Scheme Record Date, so the Commissioner's stricter approach to such cases has not been explicitly confirmed. Ultimately, the ATO should clarify (by way of a public ruling or other guidance) its view on the precise time at which a target company becomes an 'exempting entity' in the context of a scheme involving a foreign owned or controlled purchaser, particularly where the practical consequence of that view should be that the scheme timetable is adjusted so that the timing of any special dividend precedes the time at which the target company becomes an exempting entity.

[127] CR 2019/64 para 37.

Ruling	Target Entity	Foreign Purchaser	Payment Date for Dividend	Scheme Record Date	Payment Date before Scheme Record Date?	Exempting Entities Ruling?
CR 2020/3	Bellamy's Australia Limited	Purchaser is a wholly-owned subsidiary of an Australian Company which is an indirectly, wholly-owned subsidiary of a company incorporated in the Cayman Islands	23 December 2019	17 December 2019	No	No
CR 2019/73	GBST Holdings Limited	Purchaser is an indirectly wholly-owned company incorporated in the Cayman Islands	5 November 2019	25 October 2019	No	No
CR 2019/71	Villa World Limited	Purchaser is owned by a number of international institutional investors	28 October 2019	23 October 2019	No	Yes
CR 2019/64	RuralCo Holdings Limited	Purchaser is an entity that is wholly owned by Nutrien Limited (a Canadian company listed on the Toronto Stock Exchange and New York Stock Exchange)	30 September 2019	23 September 2019	No	Yes
CR 2018/44	APN Outdoor Group Limited	Purchaser is a wholly-owned subsidiary of a French company	29 October 2018	25 October 2018	No	No

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CR 2018/33	LifeHealthcare Group Limited	Various overseas funds (Delaware Limited Partnership) have ownership interests in the purchaser	25 May 2018	21 May 2018	No	No
CR 2018/27	Mantra Group Limited	Purchaser is a wholly-owned subsidiary of a French company	30 May 2018	28 May 2018	No	No
CR 2018/21	Pepper Group Limited	Purchaser is indirectly wholly-owned by certain funds, clients or accounts managed or advised by global investment firm	4 December 2017	27 November 2017	No	No
CR 2017/80	Programmed Maintenance Services Ltd	Purchaser is a wholly owned subsidiary of a company incorporated in Japan	20 October 2017	23 October 2017	Yes	No
CR 2016/81	Asciano Limited	Purchaser is indirectly owned by foreign entities in Joint Consortium	11 August 2016	12 August 2016	Yes	No

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Annexure A: ESS Class Rulings

Class Rulings issued under former section 139CE

Taxpayer	Class Ruling	Relevant Transaction	Date of Offer	SID Date	Scheme Implementation Date	Disposal in breach of disposal restriction condition?
AXA Asia Pacific Holdings Limited	CR 2011/40	AMP acquisition of the AXA APH group	Prior to 30 June 2009	29 November 2010	30 March 2011	No
Lion Nathan Limited	CR 2009/60	Kirin Holdings Company Limited acquisition of Lion Nathan Limited	First offer April 2007	10 May 2009	21 October 2009	No
St George Bank Ltd	CR 2008/64	St George Bank Ltd merger with Westpac Banking Corporation	November 2008	26 May 2008	1 December 2008	No
Panbio Limited	CR 2008/13	Inverness Medical Innovations Inc acquisition of Panbio	July each year, with the first offer being made July 2002	31 October 2007	7 January 2008	No
UNiTAB Limited	CR 2007/70	UNiTAB merger with Tattersall's Limited	On or about 30 June 2004 and 30 June 2005	31 May 2006	12 October 2006	No
Promina Group Limited	CR 2007/14	Promina Group Limited merger with Suncorp-Metway Limited	Not disclosed in CR	21 October 2006	20 March 2007	No
Freedom Group Limited	CR 2004/68	Bravoscar Nominees Pty Ltd acquisition and privatisation of Freedom Group Limited	Not disclosed in CR **but** Plan commenced in July 2003	19 August 2003	18 December 2003	No

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Class Rulings issued under current section 83A-45

Taxpayer	Class Ruling	ESS Offer Date	SID Entry Date	Implementation Date	S 83A-45(5) Discretion Exercised?
Ausnet Service Limited	CR 2022/17	24 June 2019, 26 June 2020 and 24 June 2021	31 October 2021	16 February 2022	✓
Class Limited	CR 2022/45	18 December 2019, 18 December 2020 and 22 December 2021	18 October 2021	16 February 2022	✓ shares acquired in 2019 and 2020 tranches ✕ shares acquired under the 2021 Tranche
Western Areas Limited	CR 2022/64	February 2020 and February 2021	16 December 2021	20 June 2022	✓
Youfoodz Holdings Ltd	CR 2021/82	30 October 2020	13 July 2021	27 October 2021	✓
Saracen Mineral Holdings Limited	CR 2021/45	14 May 2018, 13 May 2019 and 4 May 2020	6 October 2020	12 February 2021	✓

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Annexure B: Demerger/Acquisition Transactions

Year	Name of Transaction	Description of Transaction	Acquisition Consideration	Demerger Relief	Scrip for Scrip Rollover	Demerger expressly conditional on Acquisition	Acquisition expressly conditional on Demerger
2022	Firefly Resources Limited – Firetail Resources Limited	1) Demerger of Firetail Resources Limited by Firefly Resources Limited 2) Acquisition of 100% of the shares in Firefly Resources Limited by Gascoyne Resources Limited under a scheme of arrangement.	Scrip	✗	✓	✓	✗
	Minotaur Exploration Ltd – Demetallica Limited – Andromeda Metals Limited	1) Acquisition of Minotaur Exploration Ltd by Andromeda Metals Limited 2) Reduction of share capital from Minotaur by way of a transfer of shares in Demetallica Limited	Scrip	✗	✓	✗	✓
	BHP Group Limited – Woodside Energy Group Ltd	1) Acquisition of the entire share capital of BHP Petroleum by Woodside 2) Woodside issues new shares to BHP compromising ~48% of all Woodside shares 3) BHP distributes those shares to all BHP shareholders as an in specie fully franked dividend	Scrip	✗	N/A	✓	✗
2021	Cassini Resources Limited – OZ Minerals Limited	1) Demerger of Caspin Resources Limited by Cassini Resources Limited 2) OZ Minerals Limited acquisition of Cassini Resources Limited	Scrip	✗	✓	✓	✓
2020	TPG – Vodafone	1) Demerger of Tuas Ltd subsidiary (Singapore Co) by TPG prior to Scheme of Arrangement but conditional upon the Scheme becoming effective 2) Issue of special dividend from excess cash reserves and borrowings to bring TPG into agreed debt range 3) VHA acquisition of TPG shares	Scrip	✗	✓	✓	✗
2018	Unibail-Rodamco SE - Westfield	1) Demerger of OneMarket by Westfield Corporation Limited. 2) Unibail-Rodamco SE acquisition of stapled securities of Westfield	Cash and Scrip	✗	✓	✓	✗

	Blackstone-AMA Group Limited	1) Demerger of ACAPCo by AMA Group Limited 2) Blackstone acquisition of AMA Group Limited.	Cash only or Cash and Scrip	✗	N/A	✗	✓
2015	Independence Group NL – Sirius Resources NL	1) Demerger of S2 Resources by Sirius Resources NL 2) Independence Group NL acquisition of Sirius Resources	Cash and Scrip	✗	✓	✓	✓
2013	Sundance - Texon Petroleum Limited	1) Demerger of Talon Petroleum Limited by Texon Petroleum Limited 2) Sundance acquisition of Texon Petroleum Limited	Scrip only	✓	✓	✗	✓
	Auzex Resources Limited – Bullabulling Gold Limited	1) Demerger of Auzex Exploration Limited and Auzex Resources Limited 2) Acquisition of Auzex Resources Limited by Bullabulling Gold Limited	Scrip	✓	✓	✗	✓
	Iron Mountain – Recall Holdings	1) Demerger of Recall Holdings Ltd by Brambles Ltd (July 2013) 2) Iron Mountain Inc acquisition of Recall Holdings Ltd (Jun 2016)	Cash only or Cash and Scrip	✓	✓	✗	✗
2011	PTT Mining Limited - Straits Resources Limited	1) Demerger of Straits Metals by Straits Resources 2) PPT Mining Limited acquisition of Straits Resources Limited	Cash only	✓	✗	✗	✓
2010	CS CSG - Arrow Energy Limited	1) Demerger of Dart Energy Limited by Arrow Energy Limited 2) CS CSG acquisition of Arrow Energy Limited	Cash only	✓	N/A	✗	✓
2008	Australia Worldwide Exploration Limited - ARC Energy Limited	1) Demerger of Buru Energy Ltd by ARC Energy Ltd 2) Australia Worldwide Exploration Limited acquisition of ARC Energy Limited	Cash and Scrip	✓	✓	✓	✓
2007	Symbion - Healthscope	1) Demerger of Mayne Pharma by Mayne Group Ltd (November 2005) 2) Healthscope Limited proposed acquisition of Symbion Health Limited (ka Mayne Group Ltd) (2007)	Cash or Cash & Scrip or Scrip	✓	✓	✗	✗
2006	Hospira – Mayne Pharma	1) Demerger of Mayne Pharma by Mayne Group Ltd (November 2005) 2) Hospira acquisition of Mayne Pharma (September 2006)	Cash	✓	N/A	✗	✗
2005	Oxiana Limited – Minotaur Resources Limited	1) Demerger of Minotaur Exploration Limited (Minex) by Minotaur 2) Oxiana Limited acquisition of Minotaur Resources Limited	Scrip for Scrip	✓	✓	✗	✓

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	Woolworths Limited - Progressive Enterprises Holdings Limited	1) Demerger of Progressive Enterprises Holdings Limited by Foodland Associated Limited 2) Woolworths Limited (WOW) acquisition of FAL's New Zealand business assets and Australian Woolworths Action Stores	Cash and/or Scrip	✓	✓	✗	✓
	Metcash Limited - Foodland Associated Limited	1) Demerger of Progressive Enterprises Holdings Limited by Foodland 2) Metcash acquisition of FAL's Australian business assets (excluding Australian Woolworths Action Stores	Cash or Scrip	✓	✓	✗	✓
2004	LionOre – MPI Mines	1) Demerger of Leviathan Resources Limited from MPI Mines Ltd 2) LionOre acquisition of MPI Mines	Cash and Scrip for Scrip	✓	✓	✗	✓

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