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Scrip For Scrip Roll-Over Provisions

Key message

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M&A transactions can take many forms, but from a tax perspective one of the most useful methods of carrying out a takeover involves the scrip for scrip roll-over provisions.

Here we consider some common questions in relation to these rules.

Subdivision 124-M of the Income Tax Assessment Act 1997 (Act) provides for a roll-over where post-capital gains tax (CGT) shares, trust interests or options are replaced with other shares, trust interests or options respectively.

Roll-over provisions in operation

The roll-over operates where the original interest holder exchanges a share in an original entity for a replacement interest in another company (acquiring entity).

A separate roll-over exists under s124-781(1) which will operate where the original interest holder exchanges a unit or other interest in a trust for a unit or other interest in another trust.

Where the roll-over is chosen any capital gain otherwise made by the original interest holder on disposal of its original interest is deferred until the replacement interest is disposed.

Roll-over conditions

The following requirements must be met for the roll-over to be available (ss124-780 and 124-781):

- » the exchange must, as a consequence of a single arrangement, result in the acquirer holding 80% or more of the shares in the target
- » where trust interests are being exchanged, the arrangement must result in the acquiring entity owning 80% or more of the trust voting interests in the original entity or, if there are none, 80% or more of the units or other interests in the original entity
- » the arrangement must be one in which all owners of voting shares or interests in the original entity could participate and in which participation was available on substantially the same terms for all of the owners of interests of a particular type in the original entity
- » the original interest holder must have acquired the interests it is exchanging on or after 20 September 1985
- » the original interest holder must be in a position such that apart from the roll-over it would make a capital gain from a CGT event happening in relation to its original interest
- » the replacement interest must be an interest in the acquiring entity or the ultimate holding company of the acquiring entity
- » the original interest holder must choose to obtain the roll-over

- » where the roll-over is in relation to a trust, entities must have fixed entitlements to all of the income and capital of the original entity and the acquiring entity.

What if the 80% threshold is not met?

In order to obtain the rollover it is necessary that the acquiring entity becomes the owner of 80% or more of the voting shares in the original entity or alternatively increases its holdings so that it owns 80% or more of the voting shares in that entity.

Where that threshold is not met the rollover is not available, however other commercial objectives may still be met such as where an acquirer obtains over 50% of a target.

Value and type of replacement interest

The scrip for scrip roll-over provisions operate on the basis that a share is exchanged for a share or a trust interest is exchanged for another trust interest (ie the same value and type as the original interest). As such you cannot, for example, exchange options for shares (s124-780(1)).

Implications where the parties are not acting at arm's length

The Act imposes conditions where the original interest holder and the acquiring entity or trustee of the acquiring entity do not deal at arm's length and either:

- » neither the original entity nor the replacement entity had at least 300 members just before the arrangement started
- » the original interest holder, the original entity and an acquiring entity were all members of the same linked group just before that time.

The conditions are that the replacement interest must be of substantially the same market value and carry the same kind of rights and obligations as those attached to the original interest (ss124-780(4)).

Significant portion of shares that are subject of the rollover

Implications also exist where the shareholder holds a significant portion of shares that are the subject of the rollover.

Significant stakeholders must inform the replacement entity in writing of their cost base in the original interests. 'Significant stakeholders' include those that hold 30% or more of the voting rights in the company, rights to receive dividends or any distribution of capital.

Availability of a partial rollover

If capital proceeds for the original interest include more than just the replacement interest, the scrip for scrip roll-over can only apply to replacement interests. Where capital proceeds for the original interest include more than just the replacement interest, only a partial roll-over is available (section 124-790).

Where a partial roll-over is chosen the holder of the original interest must allocate the cost base of the original interest between the replacement interest and the ineligible proceeds.

For example in the recently announced takeover of Patrick Corporation Ltd by Toll Holdings Ltd the consideration consists of both shares in Toll and cash. Only the share component of the consideration will be eligible for rollover with the cash component being subject to tax.

Where another roll-over is available, you cannot choose scrip for scrip roll-over. Under subsection 124-795(3) you cannot obtain scrip for scrip roll-over if you can choose a roll-over under Division 122 (disposal of assets to a wholly owned company) or Subdivision 124-G (company reorganisation) of the Act.

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Takeovers Panel: Survives Constitutional Challenge (For Now) But Will It Be As Effective?

When acquiring a company two simple, but very common, issues often arise – change of control and pre-emptive rights provisions. It is important to understand the effect of these basic provisions and how they impact on the process of acquiring a company.

Key message

A recent legal challenge to a Takeovers Panel decision may lead to an increase in tactical litigation and reduce the Takeovers Panel's effectiveness.

What is the takeovers panel?

The Takeovers Panel (Panel) is the main forum for hearing complaints by a party to a takeover bid that 'unacceptable circumstances' exist in connection with the bid. It was, in part, designed to reduce the incidence of tactical litigation which often ensued during the bid process.

The Panel is comprised of experts from within the takeovers community and has enjoyed remarkable success in the takeovers process in the 5 years since its reconstitution in 2000.

This has largely been due to its ability to resolve takeover disputes quickly and effectively on the basis of commercial merits and without being subject to the

technical and timing constraints sometimes encountered within the traditional court system.

The panel's recent Austral Coal decision

The Panel recently made a declaration of 'unacceptable circumstances' in connection with Centennial Coal's takeover bid for Austral Coal.

The declaration resulted from Swiss commodities trader Glencore's non-disclosure of cash-settled equity swaps which brought Glencore's combined economic exposure to Austral Coal's share capital over the 5% limit even though, on their face, the swaps probably did not give rise to a relevant interest in the underlying shares.

Amongst other things, the Panel ordered that Glencore offer to sell Austral Coal shares to any person who had sold Austral Coal shares on-market during the period from which Glencore obtained its interest exceeding the 5% threshold.

The challenge to the panel's authority

After the Review Panel confirmed the initial Panel decision, Glencore sought a review of the decision by the High Court.

The grounds on which Glencore challenged the Panel decision included failure by the Panel to properly consider the effect of Glencore's conduct and the rights and interests of the persons affected by that conduct when making its declaration of 'unacceptable circumstances' and deciding to make the consequent orders. Glencore also argued that the provisions of the Corporations Act conferring the powers to declare circumstances surrounding a takeover bid as 'unacceptable' and to make orders in response were an exercise of judicial power and therefore unconstitutional on the basis that such powers can only be invested in a Court.

The High Court remitted the matter to the Federal Court which last month found in favour of Glencore, setting aside the declaration of 'unacceptable circumstances' and the related orders, returning the matter to the Panel for reconsideration.

While the Court did not say whether or not cash-settled equity swaps give rise to a disclosure obligation, it stated that the Panel had failed to turn its mind to the proper

questions before making a declaration of 'unacceptable circumstances' and the consequent Glencore sale orders.

Accordingly, the matter was remitted to the Panel for determination in accordance with the law.

Although the Court did not have to consider Glencore's constitutional argument, it indicated that the powers conferred upon the Panel were consistent with the Constitution.

What does the decision mean?

The decision has gone some way to settling the constitutional issue of the Panel's powers but has now opened the possibility of court proceedings for parties who are unsatisfied with the outcome of Panel proceedings. While the Court made it clear that it would generally be reluctant to intervene while a bid was on foot and the market volatile, Glencore's success certainly leaves the door open for the tactical use of litigation in the future.

Another consequence of the Court decision is that the Panel is now likely to take a more cautious and legalistic approach to applications so that its decisions do not suffer the same fate as its Austral Coal decision – particularly where there is no technical breach of the law or where there the effect of the disputed conduct is unclear. If so, the Panel's ability to provide timely, efficient and certain resolutions of takeover disputes may be inhibited.

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