

PRODUCT RULING – BR PRD 18/01

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by Livestock Improvement Corporation Limited, IRD No: 49-836-279.

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of ss BG 1, CB 1, CB 3, CB 4, CB 5, subpart CD and the **definition of “non-taxable bonus issue” in s YA 1.**

The Arrangement to which this Ruling applies

The Arrangement is a series of steps detailed below resulting in the reclassification of two classes of shares (Co-operative Control Shares and Investment Shares) currently on issue by Livestock Improvement Corporation Limited (LIC), a co-operative company registered under the Co-operative Companies Act 1996 (CCA 1996). The shares will be reclassified into a single, continuing class of shares (Ordinary Shares) listed on the New Zealand Alternative Market Exchange (NZAX).

Further details of the Arrangement are set out in the paragraphs below.

Background

1. LIC was incorporated in 1988 under the Companies Act 1955, and was subsequently reregistered under the Companies Act 1993 (CA 1993) and the CCA 1996. LIC has been a user-owned co-operative since 1 March 2002, and is owned by approximately 10,500 farmers.
2. LIC provides a range of services and solutions to improve the prosperity and productivity of its farmers. This includes dairy genetics, artificial breeding

services, information technology systems, herd testing and DNA parentage verification.

3. Currently, LIC customers must **purchase at least \$500 of LIC's products and services per season to hold a certain number of LIC's shares, based on their expenditure with LIC (the Share Standard)**. Under the Arrangement, the minimum spend before the Share Standard applies will be increased to \$1,000 (although existing Shareholders whose spend is between \$500 and \$999 will be unaffected until they exceed \$1,000, at which point they will become bound by a Minimum Purchases Amount of \$1,000).

LIC's existing capital structure

4. In April 2004, LIC implemented a capital structure involving two classes of shares: Co-operative Control Shares and Investment Shares. At that time, LIC had 2,952,859 Co-operative Control Shares on issue and 29,528,590 Investment Shares on issue. The Investment Shares have not increased since then, but (as at 31 May 2017) there are more than 6 million Co-operative Control Shares.

Co-operative Control Shares

5. Each Co-operative Control Share has a nominal value of \$1.
6. A farmer purchasing goods and services from LIC must hold a number of Co-operative Control Shares with a nominal value equal to 4% of the aggregate amounts paid (or deemed to be paid) for goods and services purchased from LIC in the preceding season.
7. Co-operative Control Shares carry voting interests. **Clause 2.1 of LIC's constitution defines a "Voting Security" as excluding Investment Shares. This ensures that voting interests are only held by transacting shareholders, in accordance with s 33 of the CCA 1996.**
8. Co-operative Control Shares carry the right to a Priority Dividend, being a specified percentage of the nominal amount of the share. The specified percentage is set by the Board in each season, and cannot exceed the first **mortgage lending rates of LIC's principal bankers in respect of secured loans** made to farmers. No other dividend is payable in respect of the Co-operative Control Shares.
9. Since the nominal value of the Co-operative Control Shares is \$1, the Priority Dividend (when paid) is always a modest amount. The concept was intended to recompense the farmers for the interest cost they would face in borrowing to purchase the Co-operative Control Shares.

Investment Shares

10. Investment Shares can only be held by persons also holding Co-operative Control Shares (due to LIC being a co-operative company) although a small allocation of Investment Shares is available to LIC employees under an employee incentive scheme.

11. Investment Shares do not carry voting interests (other than certain protective rights and the right to vote on any resolution for the purpose of liquidating LIC).
12. Investment Shares carry dividend rights. Payment of a dividend is subordinate to any Priority Dividend on the Co-operative Control Shares, but that subordination is immaterial given the modest nature of any Priority Dividend.
13. LIC listed on the NZAX in April 2004, to facilitate trading of the Investment Shares (between holders of Co-operative Control Shares). LIC was granted listing with a 'Non-Standard' (NS) designation primarily because of the restrictions on who can hold Investment Shares.

LIC's Available Subscribed Capital (ASC)

14. As at 31 May 2017 the ASC in respect of each class of share was approximately as follows:
 - Co-operative Control Shares; \$6.24m.
 - Investment Shares; \$58.46m.
15. This Ruling does not consider or rule upon whether the advised amount of ASC has been correctly calculated.

The proposed capital restructure

16. The Applicant advises that the overall objective of the Arrangement is to create a sustainable capital structure that aligns economic and voting rights. This will be achieved by providing holders of Co-operative Control Shares with a greater economic interest in LIC, while providing holders of Investment Shares with voting rights and requiring Co-operative Control Shareholders to introduce more capital for their greater economic interest.
17. **LIC's Board will reclassify the Investment Shares and Co-operative Control Shares** into Ordinary Shares on a one-for-one basis. Immediately prior to the Arrangement, **each shareholder's holding of Co-operative Control Shares** will be adjusted by reference to their expenditure with LIC in the 2017/2018 season in accordance with the Share Standard.
18. The Arrangement involving the equalisation and reclassification of shares will be **consistent with relevant provisions in the CCA 1996 and in LIC's constitution** concerning co-operative companies.

Equalisation

19. The Co-operative Control Shares have a fixed nominal value of \$1, and the Investment Shares have a fluctuating, market-based value (referred to below as \$X as at implementation of the Arrangement (Implementation Value)).
20. Accordingly, the value of the Co-operative Control Shares and the Investment Shares will need to be equalised.

Issue of further Co-Operative Control Shares

21. LIC will issue additional \$1 nominal value Co-operative Control Shares to existing shareholders.
22. The additional shares are not issued out of existing reserves. The additional Co-operative Control Shares will be nil paid and will become payable when LIC calls for payment. A call for payment will generally coincide with a decision to pay **dividends, and each shareholder's outstanding amounts will be offset** against any dividend payable.
23. **The shareholders do not have an option to elect to take money or money's worth** instead of the additional shares, or to require LIC to repurchase those shares.

Implementation Ratio

24. The number of additional nil paid Co-operative Control Shares issued is determined by the ratio of Y:1 (the Implementation Ratio), where:
 - Y** is equal to "\$X - \$1":
 - \$X** is the Implementation Value of an Investment Share (as at implementation).
 - \$1** is the nominal value of a Co-operative Control Share.
 - 1** is each Co-operative Control Share held prior to implementation.
25. The above steps assume that the valuation of the Investment Shares is a simple (non-fractional) multiple of the nominal \$1 value of the Co-operative Control Shares. If this is not the case, then the Implementation Ratio will be applied so as to ensure that a whole number of additional Co-operative Control Shares will be issued.
26. **The Implementation Value (\$X) will be determined by LIC's Board, with the benefit of an independent adviser's report** (which will be made available to shareholders), external financial advice provided to the Board, and taking into account the market price of the Investment Shares as traded on NZAX. Given low trading volumes, the NZAX market price for Investment Shares is not necessarily a reliable indicator of the true market value of Investment Shares.

Subdivision of Investment Shares

27. LIC will then subdivide each Investment Share to ensure that the value of an Investment Share on implementation, having regard to the Implementation Value, equals \$1. If, for a particular shareholder, the subdivision calculation does not produce a whole number, the number of Investment Shares will be rounded up to the nearest whole number. The value of each Investment Share will then be equal to the nominal value of each Co-operative Control Share.
28. This will increase the number of Investment Shares by the Implementation Ratio (the same ratio as the increase in Co-operative Control Shares).

29. Upon completion of the above steps, the value of the Investment Shares and the nominal value of the Co-operative Control Shares will have been equalised (albeit with the new Co-operative Control Shares being paid up as to nil). The overall ratio of Investment Shares to Co-operative Control Shares will remain the same as it was immediately prior to implementation.
30. LIC will not elect to treat the share subdivision as a dividend under s CD 8 of the ITA 2007.

Share reclassification

31. After equalisation, all Co-operative Control Shares and Investment Shares will be reclassified as Ordinary Shares. This will occur by way of a constitutional alteration of the rights attaching to the shares.
32. Nil paid Co-operative Control Shares will become nil paid Ordinary Shares.
33. A number of the above steps, including the subdivision of Investment Shares and the reclassification of Co-operative Control Shares and Investment Shares into Ordinary Shares, will need to be approved at a meeting of LIC shareholders. The reclassification will require two resolutions to be passed, one by Co-operative Control Shareholders only, and one by interest classes of each of the Co-operative Control Shareholders and Investment Shareholders.

Issue of and calls on nil paid shares

34. A co-operative company is not required to obtain the consent of a shareholder for the issue of shares imposing or increasing a liability of that person to the company. Accordingly, LIC is able to issue nil paid shares to all holders of Co-operative Control Shares, without the consent of every shareholder.
35. Following reclassification of nil paid Co-operative Control Shares as nil paid Ordinary Shares, the Board will, from time to time, make a call for full payment of the outstanding issue price of one or more nil paid Ordinary Shares held by a shareholder. LIC's constitution allows the Board to "make Calls for the payment of any amounts unpaid on Securities which are not payable at a fixed time or times by the terms of issue of those Securities." The amount of the call is payable at the time specified on the giving of at least ten working days' notice.
36. A call will coincide with the declaration of a dividend. The number of a **shareholder's nil paid** Ordinary Shares in relation to which a call is made for full payment of the outstanding issue price will be determined by dividing the net cash dividend by the outstanding issue price of the nil paid shares. Any dividends paid on nil paid Ordinary Shares and on any other shares required to be held to satisfy the Share Standard will be applied to repay the outstanding issue price.

Restriction on trading nil paid shares and shareholder-requested calls

37. The Investment Shares are currently traded on the NZAX. After reclassification of all Co-operative Control Shares and Investment Shares into Ordinary Shares, the Ordinary Shares will be traded on the NZAX. There is no practical way to have less than fully paid shares traded on the NZAX, since such shares will have a

lesser tradable value than fully paid shares due to the potential for calls on such shares. Consequently, nil paid Ordinary Shares issued by LIC will not be able to be traded on the NZAX until paid in full.

38. The Board reserves the right to approve the transfer of nil paid Ordinary Shares before they have been paid up in full, which it expects to exercise in exceptional circumstances only. In the event that nil paid Ordinary Shares are transferred, the transferee will remain subject to calls for payment in the same way and in the same circumstances as the transferor of those shares. While it will not be a matter **within the Company's control**, any consideration paid for the transfer of the shares would be expected to take this liability into account.
39. To facilitate trading, shareholders will be able to apply dividends on any additional Ordinary Shares they own to pay up the nil paid Ordinary Shares. They can also make additional payments if they wish to pay up the nil paid Ordinary Shares sooner. Shareholders will need to give notice to LIC in writing if they wish to exercise these rights.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- a) The issue of additional nil paid Co-operative Control Shares will not give rise to a taxable dividend to Co-operative Control Shareholders under subpart CD.
- b) **The subdivision of the Investment Shares will be a "non-taxable bonus issue"** as defined in s YA 1. Accordingly, under s CD 29, the subdivision will not give rise to a dividend to holders of Investment Shares.
- c) The reclassification of Co-operative Control Shares and Investment Shares as Ordinary Shares of the same class will not give rise to a taxable dividend under subpart CD.
- d) The Arrangement does not involve a disposal of shares by the shareholders. For the purposes of ss CB 1, CB 3, CB 4 and CB 5, no amount is derived by the shareholders as a result of the Arrangement.
- e) Section BG 1 does not apply to the Arrangement.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 9 February 2018 and ending on 31 March 2019.

This Ruling is signed by me on the 9th day of February 2018.

Howard Davis

Director (Taxpayer Rulings)