



Class Ruling

Income tax: demerger of MPG Printing Limited by McPherson's Limited

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❗ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45BA of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 109-10 of the ITAA 1997;
- section 115-25 of the ITAA 1997;
- section 115-30 of the ITAA 1997;

- Subdivision 115-A of the ITAA 1997;
- section 975-300 of the ITAA 1997;
- Division 110 of the ITAA 1997; and
- Division 125 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the holders of shares in McPherson's Limited (McPherson's) who:

- (a) were listed on the share register of McPherson's as at the Demerger Record Date (Record Date);
- (b) held their McPherson's Limited shares (McPherson's shares) on capital account on the Record Date;
- (c) were a 'resident of Australia' as defined in subsection 6(1) of the ITAA 1936 on the Record Date; and
- (d) were not subject to the taxation of financial arrangement rules in Division 230 of the ITAA 1997 in relation to gains and losses on their McPherson's shares.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

4. In this Ruling, a person belonging to this class of entities is referred to as a 'McPherson's shareholder'.

Qualifications

5. The Commissioner makes this Ruling based on the precise Scheme identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 10 to 29 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies from 1 July 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

10. The following description of the scheme is based on information provided by the applicant for this ruling.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Background

11. On 31 January 2012 (Implementation Date), McPherson's carried out a demerger of all the shares in MPG Printing Limited (MPG) by way of an in-specie distribution, whereby all of the issued shares in MPG held by McPherson's were transferred to McPherson's shareholders. The demerger was announced by the McPherson's Board on 18 November 2011 and had the purpose of separating the printing business.

12. The transfer was done on a pro rata basis partly by way of dividend and partly by way of capital reduction. One share in MPG was transferred to each McPherson's shareholder for every four McPherson's shares that a McPherson's shareholder held at the Record Date, with fractional entitlements rounded up to the next whole number of shares.

Relevant Entities

McPherson's

13. McPherson's is an Australian resident company listed on the Australian Securities Exchange (ASX). McPherson's is also the head company of a consolidated tax group for the purposes of Part 3-90 of the ITAA 1997.

14. McPherson's operates in two distinct sectors:

- marketing and distribution of household consumer products; and
- book and commercial printing.

15. McPherson's had 72,401,758 shares on issue as at 31 January 2012 and its share capital account is not tainted for the purposes of Division 197 of the ITAA 1997.

16. McPherson's franking account balance as at 31 January 2012 was \$27,622,546.

MPG

17. MPG (formerly MPG Printing Pty Ltd and Owen King Holdings Pty Ltd) is an unlisted public company resident in Australia. The company was wholly owned by Domenica Pty Ltd (Domenica).

18. MPG owns 100% of shares in McPherson's Printing Pty Ltd.

Shareholder profile

19. Resident shareholders, who are a mix of individuals, companies and superannuation funds, legally hold approximately 98% of the shares in McPherson's.

20. Non-resident shareholders, the majority of which are New Zealand residents, own approximately 2% of the shares in McPherson's.

21. McPherson's has an employee share option plan and a number of employee share plans in place. The employees' entitlement may be adjusted on a no detriment basis.

Demerger transaction

22. The demerger of MPG from the McPherson's demerger group was executed by an *in-specie* distribution of 100% of the shares in MPG to the shareholders of McPherson's. The distribution comprised a reduction in share capital of McPherson's and a payment of a demerger dividend to eligible McPherson shareholders.

23. The following steps were taken in order to complete a reorganisation to facilitate the demerger:

- Conversion of 300,000 preference shares held by Domenica in MPG to ordinary shares.
- Creation of 17,040,438 additional ordinary shares by way of a share split.
- Issue of 1,174 additional ordinary shares in connection with the rounding up of fractional entitlements.
- Domenica distributed its entire MPG shareholding to McPherson's by debiting its retained earnings;
- McPherson's declared an *in specie* distribution of all of the shares in MPG to McPherson's shareholders;
- The *in specie* distribution comprised a capital return of \$26,084,511 and a demerger dividend of \$1,460,489. The dividend and capital return were sufficient to enable McPherson's to divest itself of 100% of its holding of MPG shares.

Reasons for the demerger

24. McPherson's has advised that the key drivers for the demerger were:

- McPherson's would be able to become a single-focus consumer products company;
- The McPherson's board of directors and management would be able to focus solely on the consumer products business;
- McPherson's would have the capacity to pursue growth opportunities in the consumer industry; and
- The Demerger would promote a positive market perception through the streamlining of business operations and constitutes a logical progression for MPG given the operating performance of the printing business offering potential for consolidation opportunities through acquisition or merger of compatible printing businesses.

Accounting for the distribution to effect the demerger

25. McPherson's accounted for the distribution that effected the demerger by debiting its share capital by the capital reduction amount, \$26,084,511, determined by reference to the proportion of the relative market values of MPG and the McPherson's group

26. The dividend amount, \$1,460,489, equals the difference between the market value of MPG at the time of the demerger and the capital reduction amount. This amount was debited to McPherson's retained earnings account.

Other matters

27. McPherson's did not make an election under subsection 44(2) of the ITAA 1936 that subsections 44(3) and 44(4) of the ITAA 1936 will not apply to the dividend component of the demerger distribution.

28. Just after the demerger, at least 50% of the market value of capital gains tax (CGT) assets owned by MPG or its subsidiaries were used directly or indirectly in one or more businesses carried on by MPG or any of its subsidiaries.

29. MPG has entered into an agreement to acquire the OPUS Group, conditional on approval by MPG shareholders at a general meeting in March 2012.

Ruling

CGT consequences

CGT event G1

30. CGT event G1 happened in relation to each McPherson's share owned by a McPherson's shareholder at the time McPherson's made the payment of the capital reduction amount under the demerger (section 104-135 of the ITAA 1997).

Capital Gain

31. McPherson's shareholders made a capital gain when CGT event G1 happened if the capital reduction amount exceeded the cost base of the McPherson's share (subsection 104-135(3) of the ITAA 1997). No capital loss can be made when CGT event G1 happens.

32. A capital gain made when CGT event G1 happened is disregarded if the McPherson's shareholder acquired the McPherson's share before 20 September 1985 (pre-CGT McPherson's share) (subsection 104-135(5) of the ITAA 1997).

Demerger roll-over relief

33. A demerger, as defined under section 125-70 of the ITAA 1997, happened to the McPherson's demerger group under the scheme.

34. McPherson's shareholders can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their McPherson's shares.

Choosing demerger roll-over relief for pre-CGT McPherson's shares

35. McPherson's shareholders who choose demerger roll-over relief for their pre-CGT McPherson's shares are taken to have acquired the corresponding MPG shares under the demerger before 20 September 1985 (subsections 125-55(1), 125-80(5) and 125-80(6) of the ITAA 1997).

Choosing demerger roll-over relief for post-CGT McPherson's shares

36. McPherson's shareholders who acquired their McPherson's shares after 19 September 1985 (post-CGT McPherson's shares) disregard any capital gain made when CGT event G1 happened if they choose demerger roll-over relief (subsections 125-55(1) and 125-80(1) of the ITAA 1997).

37. If a McPherson's shareholder chooses demerger roll-over relief for their post-CGT McPherson's shares, they must recalculate the cost base and reduced cost base of their McPherson's and MPG shares.

38. The first element of the cost base and reduced cost base of each post-CGT McPherson's share and corresponding MPG share received under the demerger is worked out as follows:

- take the sum of the cost bases of the post-CGT McPherson's shares (just before the demerger); and
- apportion that sum over the remaining post-CGT McPherson's shares and corresponding new MPG shares received under the demerger.

39. The apportionment of this sum is done on a reasonable basis having regard to the market values of the McPherson's shares and MPG shares, or a reasonable approximation of those market values at the relevant date (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

40. For the purposes of the cost base and reduced cost base apportionment, the Commissioner accepts the market value of MPG shares, \$27,545,000, and the market value of the McPherson's ordinary shares, \$127,933,906, both as at Implementation Date (31 January 2012), as a reasonable approximation of the relative market values of those shares just after the demerger. The cost bases are therefore attributed as 17.72% to MPG shares and 82.28% to McPherson's shares.

Demerger roll-over relief is not chosen for pre-CGT McPherson's shares

41. For McPherson's shareholders who own pre-CGT McPherson's shares and do not choose demerger roll-over relief:

- none of the corresponding MPG shares acquired under the demerger are taken to be pre-CGT shares;
- those MPG shares are acquired on the Implementation Date of the demerger (31 January 2012) (section 109-10 of the ITAA 1997); and
- the first element of the cost base and reduced cost base of those MPG shares is calculated in accordance with the rules in Division 110 of the ITAA 1997.

Demerger roll-over relief is not chosen for post-CGT McPherson's shares

42. For McPherson's shareholders who own post-CGT McPherson's shares and do not choose demerger roll-over relief:

- they are not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their McPherson's shares under the demerger; and
- the first element of the cost base and reduced cost base of each post-CGT McPherson's share and the corresponding MPG share is calculated in the manner described in paragraph 38 of this Ruling (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of the MPG shares for the purposes of the CGT discount

43. For the purposes of determining eligibility for a discount capital gain, the MPG shares received by a McPherson's shareholder in relation to post-CGT McPherson's shares are taken to have been acquired on the same date as the corresponding McPherson's shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This is the case irrespective of whether demerger roll-over relief is chosen or not.

44. For MPG shares acquired in relation to pre-CGT McPherson's shares under the demerger where demerger roll-over relief is not chosen, the acquisition date of these MPG shares for the purposes of the CGT discount is the Implementation Date of the demerger, 31 January 2012.

Demerger dividend

45. Any dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936).

46. Any demerger dividend is neither assessable income nor exempt income of the participating McPherson's shareholders (subsections 44(3) and 44(4) of the ITAA 1936).

47. As the share capital reduction amount was debited to McPherson's share capital account it is not a dividend, as defined in subsection 6(1) of the ITAA 1936 (see the exclusion contained in paragraph (d) of the definition of a dividend contained in subsection 6(1)).

Application of sections 45B, 45BA and 45C of the ITAA 1936

48. The Commissioner will not make a determination under paragraph 45B(3)(a) of the ITAA 1936 that section 45BA of the ITAA 1936 applies to the whole or any part of any demerger benefit provided to McPherson's shareholders under the demerger.

49. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole or any part of the capital benefit provided to McPherson's shareholders under the demerger.

Commissioner of Taxation

14 March 2012

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

CGT event G1

50. CGT event G1 happened in relation to the McPherson's shares owned by McPherson's shareholders at the time that McPherson's made the payment of the capital reduction amount. The payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount taken to be a dividend under section 47 of the ITAA 1936 (section 104-135 of the ITAA 1997).

51. A McPherson's shareholder made a capital gain if the capital reduction amount exceeded the cost base of their McPherson's shares. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

52. A McPherson's shareholder cannot make a capital loss when CGT event G1 happens (note 1 of subsection 104-135(3) of the ITAA 1997).

53. If the McPherson's share to which the payment relates was acquired by a McPherson's shareholder at least 12 months before the payment of the capital reduction amount, a capital gain made from CGT event G1 may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

54. A McPherson's shareholder who acquired their McPherson's shares before 20 September 1985 disregards any capital gain made when CGT event G1 happened (subsection 104-135(5) of the ITAA 1997).

The demerger roll-over relief

55. Demerger roll-over enables a shareholder to choose to disregard a capital gain made as a result of CGT event G1 happening when a non-assessable payment is made in relation to a share under a demerger.

56. The demerger roll-over provisions in Division 125 of the ITAA 1997 contain a number of conditions for eligibility to choose demerger roll-over relief. The main conditions that are relevant to the Scheme are:

- (a) a shareholder owns a share in a company;
- (b) the company is the head entity of a demerger group;
- (c) a demerger happens to the demerger group; and

- (d) under the demerger, a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity and nothing else.

57. Under the scheme to which this Ruling relates the conditions for demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied.

58. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3) of the ITAA 1997, the Commissioner accepts as a reasonable approximation of the relative market values just after the demerger, the market value of the MPG shares, \$27,545,000, and the market value of the McPherson's ordinary shares, \$127,933,906, both as at Implementation Date (31 January 2012).

Demerger Dividend

59. Subsection 44(1) of the ITAA 1936 operates to include in a shareholder's assessable income any dividends, within the meaning of that term in subsection 6(1) of the ITAA 1936, paid to a shareholder out of company profits.

60. Paragraph 6(1)(d) of the definition of 'dividend' excludes amounts debited against an amount standing to the credit of the share capital account of the company.

61. 'Share capital account' is defined in section 975-300 of the ITAA 1997 as an account that the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

62. However, subsection 975-300(3) of the ITAA 1997 provides that an account is not a share capital account if it is tainted. A share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the share capital account where the account is not already tainted.

63. In the circumstances of the McPherson's demerger, McPherson's debited the amount of \$26,084,511 to its 'share capital account' (as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300 of the ITAA 1997). This amount is therefore not a dividend for the purposes of subsection 6(1) of the ITAA 1936 and is not assessable under subsection 44(1) of the ITAA 1936.

64. McPherson's shareholders also received a dividend of \$1,460,489 being the amount by which the market value of the MPG shares transferred under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

65. However, this dividend is neither assessable income nor exempt income (subsections 44(3) and 44(4) of the ITAA 1936) if:

- the dividend is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936);

- the head entity does not elect that subsections 44(3) and 44(4) of the ITAA 1936 do not apply to the demerger dividend (subsection 44(2) of the ITAA 1936); and
- subsection 44(5) of the ITAA 1936 is satisfied.

66. In the present circumstances, as each of the conditions in paragraph 65 of this Ruling are satisfied, the dividend component received by McPherson's shareholders under the demerger is neither assessable income nor exempt income pursuant to the operation of subsections 44(3) and 44(4) of the ITAA 1936.

Application of section 45B of the ITAA 1936

67. The purpose of section 45B of the ITAA 1936 is to ensure that relevant amounts distributed to shareholders of a company are treated as dividends for tax purposes if:

- (a) components of a demerger allocation as between capital and profit do not reflect the circumstances of the demerger; or
- (b) certain payments, allocations and distributions are made in substitution for dividends (subsection 45B(1) of the ITAA 1936).

68. Subsection 45B(2) of the ITAA 1936 provides that the section applies if:

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company;
- (b) under the scheme the taxpayer obtains a tax benefit as defined in subsection 45B(9) of the ITAA 1936; and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling the taxpayer to obtain the tax benefit.

69. In the circumstances of this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 are met, the requisite purpose (paragraph 45B(2)(c) of the ITAA 1936) of enabling McPherson's shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit), is not present.

70. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(a) or 45B(3)(b) of the ITAA 1936 that either section 45BA or 45C of the ITAA 1936 applies to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

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- cost base adjustments
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- demerger benefit
- demerger dividend
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- demerger subsidiary
- return of capital on shares

Legislative references:

- ITAA 1936 6(1)
 - ITAA 1936 44
 - ITAA 1936 44(3)
 - ITAA 1936 44(4)
 - ITAA 1936 45B
 - ITAA 1936 45B(1)
 - ITAA 1936 45B(2)
 - ITAA 1936 45B(9)
 - ITAA 1936 45B(2)(a)
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 - ITAA-1997 104-135
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 - ITAA-1997 125-80(6)
 - ITAA-1997 125-85(1)
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 - ITAA-1997 975-300
 - ITAA-1997 975-300(3)
 - ITAA-1997 995-1(1)
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