



Class Ruling

Income tax: demerger of Establish Property Group Ltd by Australian Finance Group 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 45 of the ITAA 1936
- section 45A 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 115-30 of the ITAA 1997, and
- Division 125 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997, unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is shareholders of Australian Financial Group Limited (AFG) who:

- (a) were registered on the AFG share register on 21 April 2015 (Record Date)
- (b) held their AFG shares on capital account, that is, they are neither held as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1))
- (c) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on 22 April 2015, and
- (d) were not subject to the taxation of financial arrangement rules in Division 230 in relation to gains and losses on their AFG shares.

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

In this Ruling, a person belonging to this class of entities is referred to as an 'AFG shareholder'.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. 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 8 to 31 of this Ruling.

6. 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.

Date of effect

7. This Ruling applies from 1 July 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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

8. The following description of the scheme is based on information provided by the applicant.

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

9. The scheme that is the subject of this Ruling involved the demerger of Establish Property Group Ltd (EPG) by AFG on 22 April 2015.

AFG

10. As at 22 April 2015, AFG was a public company not listed on the Australian Securities Exchange. AFG had 93,740,444 ordinary shares on issue as at 22 April 2015.

11. AFG is the head company of the AFG tax consolidated group.

12. AFG was established in 1994 as a mortgage aggregator providing mortgage brokers with access to product and support. AFG has since diversified into commercial finance, insurance products, property development and securitised products.

Property development interests

13. In 2003, AFG started to undertake property development projects. AFG's property development interests have since grown significantly.

14. Prior to the demerger, AFG conducted the property development business through its wholly owned subsidiaries and by direct investment in other property developments.

15. The property development business has been funded using surplus funds of AFG and external finance. No capital raisings have been undertaken to raise funds for any of the property development interests.

Pre-demerger transactions

16. In December 2014, AFG incorporated EPG, a new, wholly owned public company.

17. AFG and EPG entered into a sale agreement under which AFG agreed to transfer its property development interests to EPG in consideration for the issue of shares in EPG. The transfer of shares was subject to receiving approval by AFG shareholders at the general meeting.

18. Shareholder approval was received on 20 April 2015 and the property development interests were transferred from AFG to EPG at book value.

19. Intercompany loans AFG made to EPG and its subsidiaries were forgiven prior to the demerger. AFG agreed to maintain guarantees for loans made to EPG and its subsidiaries from external sources until the relevant loans have been repaid or the relevant obligations discharged.

20. AFG and EPG entered into a shared services agreement whereby AFG will provide certain transitional services to EPG to support EPG's corporate functions for a period of 2 years after the demerger (or such shorter period as EPG requires).

The demerger

21. On 22 April 2015 (Implementation Date), the demerger of EPG occurred by AFG:

- reducing its share capital by the capital reduction amount of \$1,187,623, which was applied proportionately against the AFG shares on issue
- declaring a special dividend of \$27,709,745 to the AFG shareholders, and
- satisfying its obligation to pay the capital reduction amount and the special dividend to AFG shareholders by making an in specie distribution of all of its EPG shares to AFG shareholders.

22. The total market value of the in specie distribution at the date of the demerger was \$28,897,368.

23. The capital reduction amount debited to the share capital account was calculated by determining the relative market value of EPG to the aggregate market value of the AFG group at the implementation date of the demerger. This ratio was applied to reduce the share capital account to reflect the capital element of the distribution.

24. The special dividend was calculated by reducing the total market value of the in specie distribution by the capital reduction amount.

25. AFG shareholders received one share in EPG for each ordinary share they held in AFG on the Record Date.

26. AFG shareholders retained their existing direct interest in AFG. AFG did not retain any shares in EPG.

Accounting for the distribution to effect the demerger

27. AFG accounted for the distribution of EPG shares under the demerger by:

- debiting its share capital account by the capital reduction amount of \$1,187,623, and
- debiting retained earnings by the amount of the special dividend of \$27,709,745.

Reasons for the demerger

28. AFG's primary reason for undertaking the demerger was to separate the property development business into an independent company with a property development focus. The commercial rationale for the transaction includes:

- AFG's existing finance and property businesses are not adequately benefiting from being part of the same group structure and there will be greater long term operational efficiency and growth opportunities if they are separated.
- The property development interests do not fit neatly with AFG's other financial activities as each have different risk and earnings profiles.
- The property development assets divert attention away from the quality of AFG's finance assets and are potentially undervalued while sitting within a financial services company.
- As a stand-alone company, EPG will be able to develop a tailored strategy, with its own management, suitable to the property development industry.
- Both AFG and EPG will have the flexibility to offer their own shares for potential corporate transactions and to independently access capital market as required.

Other matters

29. Immediately before the demerger, AFG's share capital account was not 'tainted', within the meaning of Division 197.

30. Just after the demerger, at least 50% of the market value of CGT assets of EPG and its subsidiaries were used directly, or indirectly, in one or more businesses carried on by EPG or any of its subsidiaries.

31. AFG will not make an election in writing under subsection 44(2) of the ITAA 1936 for subsection 44(3) and subsection 44(4) not to apply to the AFG shareholders.

Ruling

CGT consequences

CGT event G1

32. CGT event G1 happened in relation to each AFG share owned by an AFG shareholder at the time AFG made the payment of the capital reduction amount (satisfied by the in specie distribution of EPG shares) (section 104-135).

33. An AFG shareholder makes a capital gain when CGT event G1 happened if the market value of the capital reduction amount received for each AFG share exceeded the cost base of that share. The capital gain is equal to the amount of the excess and the cost base and reduced cost base of the AFG share is reduced to nil (subsection 104-135(3)). No capital loss can be made when CGT event G1 happens.

Demerger roll-over relief

34. An AFG shareholder who is a resident of Australia can choose to obtain a roll-over under subsection 125-55(1) and can disregard any capital gain made when CGT event G1 happened to their AFG shares under the demerger.

Cost base adjustments

35. If an AFG shareholder chooses to obtain a roll-over they must also recalculate the cost base and reduced cost base of their AFG shares and calculate the cost base and reduced cost base of their new EPG shares.

36. The first element of the cost base and reduced cost base of each AFG share and corresponding EPG share received under the demerger is worked out under subsections 125-80(2) and 125-80(3) as follows:

- sum the cost bases of the AFG shares (just before the demerger), and
- apportion that sum over the AFG shares and corresponding new EPG shares received under the demerger.

37. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the AFG shares and EPG shares, or a reasonable approximation of those market values.

38. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3), the Commissioner accepts that a reasonable apportionment of the summed cost base is to:

- attribute 90.645% of the summed cost base to the AFG shares, and
- attribute 9.355% of the summed cost base to the EPG shares.

AFG shareholders who do not choose roll-over

39. An AFG shareholder who does not choose a roll-over

- cannot disregard any capital gain made when CGT event G1 happened to their AFG shares under the demerger, and
- must make the same adjustments to the cost base and reduced cost base of each AFG share and corresponding EPG share as described in paragraphs 35 to 38 of this Ruling (section 125-85).

Acquisition date of EPG shares

40. For the purpose of determining eligibility for a discount capital gain, the EPG shares received by an AFG shareholder under the demerger will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding AFG shares (item 2 in the table in subsection 115-30(1)). This will be the case whether or not a roll-over is chosen.

Dividend consequences

41. The capital reduction amount is not a dividend as defined in subsection 6(1) of the ITAA 1936.
42. The special dividend is a demerger dividend as defined in subsection 6(1) of the ITAA 1936.
43. The special dividend is neither assessable income nor exempt income of an AFG shareholder under subsections 44(3) and 44(4) of the ITAA 1936.

Application of sections 45, 45A and 45B of the ITAA 1936

44. Section 45 of the ITAA 1936 will not apply to the whole or any part of the EPG shares received by AFG shareholders.
45. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in respect of the capital benefits provided to AFG shareholders under the demerger.
46. 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 the demerger benefit provided to an AFG shareholder under the demerger.
47. 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 (the capital reduction amount) provided to an AFG shareholder under the demerger.

Commissioner of Taxation

10 June 2015

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 consequences

CGT event G1

48. CGT event G1 (section 104-135) happens when:

- a company makes a payment to a shareholder in respect of a share they own in the company
- some or all of the payment is not a dividend (as defined in subsection 995-1(1)) or an amount that is taken to be a dividend under section 47 of the ITAA 1936, and
- the payment is not included in the shareholder's assessable income.

49. CGT event G1 happened in relation to each AFG share owned by an AFG shareholder at the time AFG made the payment of the capital reduction amount (satisfied by the in specie distribution of EPG shares).

Demerger roll-over relief

50. The demerger roll-over relief in Subdivision 125-B enables AFG shareholders to disregard a capital gain made under the demerger if certain conditions are met. The relevant conditions in subsection 125-55(1) are satisfied because:

- AFG was the head entity of a demerger group, as defined in section 125-65
- a demerger, as defined under section 125-70, happened to the AFG demerger group (which included EPG), and
- under the demerger, CGT event G1 happened to the AFG shares and AFG shareholders acquired new shares in EPG, a demerged entity as defined in subsection 125-70(6).

51. Under subsection 125-80(1), if an AFG shareholder chooses to obtain a rollover, any capital gain from CGT event G1 happening under the demerger is disregarded.

Distribution of share capital is not a dividend

52. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes a distribution made by a company to any of its shareholders, whether in money or other property. However, paragraph (d) of the definition of 'dividend' excludes a distribution that is debited against an amount standing to the credit of the share capital account of the company.

53. Subsection 975-300(3) states that an account is generally not taken to be a share capital account if it is tainted. AFG has confirmed that its share capital account is not tainted within the meaning of Division 197.

54. AFG accounted for the in specie distribution by debiting its share capital account by the capital reduction amount and debiting the retained earnings by the special dividend amount. That part of the in specie distribution debited to the share capital account will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

Demerger dividend

55. AFG shareholders received a dividend (the special dividend) to the extent that the market value of the EPG shares distributed under the demerger exceeded the amount of the distribution debited against the share capital account (see Taxation Ruling TR 2003/8).

56. This dividend will be treated as not assessable income or exempt income under subsections 44(3) and 44(4) of the ITAA 1936 if:

- the dividend is a demerger dividend
- the head entity does not elect for subsections 44(3) and 44(4) to not apply to the dividend, and
- just after the demerger, CGT assets owned by the demerged entity or a demerger subsidiary representing at least 50% by market value of all the CGT assets (or a reasonable approximation of market value) owned by the demerged entity and its demerger subsidiaries are used, directly, or indirectly in one or more businesses carried on by one or more of those entities (subsection 44(5)).

57. Subsection 6(1) of the ITAA 1936 defines 'demerger dividend' to mean that part of a demerger allocation that is assessable as a dividend under subsection 44(1) of the ITAA 1936 or that would be so assessable apart from subsection 44(3) and (4).

58. The demerger allocation is the total market value of the EPG shares distributed to AFG shareholders under the demerger. Therefore, the special dividend is a demerger dividend as it is the amount of demerger allocation that exceeded the amount debited to AFG's share capital account.

59. The special dividend is not assessable income or exempt income of AFG shareholders under subsections 44(3) and 44(4) of the ITAA 1936 because:

- the special dividend is a demerger dividend
- AFG, as the head entity of the demerger group did not elect that subsections 44(3) and 44(4) will not apply to the demerger dividend, and
- Subsection 44(5) of the ITAA 1936 is satisfied.

Application of sections 45, 45A and 45B of the ITAA 1936

Section 45

60. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10% (subsection 45(3) of the ITAA 1936).

61. The in specie distribution of shares in EPG was made to all AFG shareholders in proportion to their ownership interests in AFG. Therefore, section 45 of the ITAA 1936 will not apply to the whole or any part of the EPG shares received by AFG shareholders.

Section 45A

62. Section 45A of the ITAA 1936 is an anti-avoidance provision that applies where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of capital, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

63. Although a 'capital benefit', as defined in paragraph 45A(3)(b) of the ITAA 1936, is provided to AFG shareholders as part of the demerger distribution, all shareholders will benefit equally and there is no indication of 'streaming' of capital benefits to some shareholders and dividends to others.

64. Therefore, section 45A of the ITAA 1936 will not apply to the whole or any part of any capital benefits provided to AFG shareholders and the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies.

Section 45B

65. Section 45B of the ITAA 1936 applies to ensure that relevant amounts are treated as dividends for taxation 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).

66. Subsection 45B(2) of the ITAA 1936 provides (relevantly) 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.

67. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, subsection 45B(3) empowers the Commissioner to make a determination that either section 45BA of the ITAA 1936 applies in relation to a demerger benefit or section 45C of the ITAA 1936 applies in relation to a capital benefit.

68. In this case, the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 are met. However, having considered the relevant circumstances of the scheme, it is concluded the requisite purpose of enabling the AFG shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

69. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(a) or paragraph 45B(3)(b) of the ITAA 1936 that section 45BA or section 45C of the ITAA 1936 applies.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- capital benefit
- capital gains
- CGT event G1 – G3 – shares
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary
- return of capital on shares

Legislative references:

- ITAA 1936 45B
- ITAA 1936 45B(1)
- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(3)
- ITAA 1936 45B(3)(a)
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- ITAA 1936 45B(9)
- ITAA 1936 45BA
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 115-30
- ITAA 1997 115-30(1)
- ITAA 1997 Div 125
- ITAA 1997 Subdiv 125-B
- ITAA 1997 125-55(1)
- ITAA 1997 125-65
- ITAA 1997 125-70
- ITAA 1997 125-70(6)
- ITAA 1997 125-80(1)
- ITAA 1997 125-80(2)
- ITAA 1997 125-80(3)
- ITAA 1997 125-85
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 975-300(3)
- ITAA 1997 977-50
- ITAA 1997 995-1(1)
- TAA 1953
- ITAA 1936 6(1)
- ITAA 1936 6(1)(d)
- ITAA 1936 44
- ITAA 1936 44(1)
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- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 44(5)
- ITAA 1936 45
- ITAA 1936 45(3)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)

ATO references

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