

CR 2003/66 - Income tax: capital gains: demerger roll-over relief for shareholders: demerger of Tethyan Copper Company Limited from Mincor Resources NL

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Class Ruling

Income tax: capital gains: demerger roll-over relief for shareholders: demerger of Tethyan Copper Company Limited from Mincor Resources NL

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings TR 92/1** and **TR 97/16** together explain when a Ruling is a ‘public ruling’ and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Subsection 115-30(1) of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - Division 125 of the ITAA 1997 (*New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures)* No 90 of Act 2002);
 - Section 136-10 of the ITAA 1997;
 - Subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Section 44 of the ITAA 1936;
 - Section 45B and section 45BA of the ITAA 1936;
 - Section 45C of the ITAA 1936;
 - Section 128B of the ITAA 1936; and
 - Part IVA of the ITAA 1936.

Class of persons

3. The class of persons to whom this Ruling applies are:
 - Ordinary shareholders of Mincor Resources NL ('Mincor') registered as ordinary shareholders on the date of the demerger (the shares held by these shareholders to be known as 'Mincor Shares'); and
 - Tethyan Copper Company Limited ('TCC') shareholders who own 'put options' ('Mincor Options') to exchange their existing TCC shares and options for shares in Mincor, and have not exercised their options under the put option agreement at the date of the demerger.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 19.
6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:
 - (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
 - (b) this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies from the date the proposed Demerger is effected pursuant to approvals obtained under Part 5.1 of the Corporations Act, the ASX under the Listing Rules, and from Mincor shareholders. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

9. This Ruling is withdrawn from 30 June 2004.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Letter dated 19 May 2003 from PriceWaterhouseCoopers ('PWC') requesting the issue of a Class Ruling, pursuant to section 14ZAAF of the *Tax Administration Act 1953*;
- E-mail advice from PWC dated 22 May 2003 showing distribution of ownership interests pre and post demerger;
- E-mail advice from PWC dated 13 June 2003 confirming questions to be answered in the ruling issued;
- E-mail advice from PWC dated 18 June 2003 showing assets pre and post demerger;
- E-mail advice from PWC dated 28 July 2003 including an independent market valuation of TCC's assets; and
- E-mail advices from PWC dated 30 July 2003 advising of changes in shareholdings in Mincor and TCC.

Note: certain information received from PWC has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation

11. Mincor intends to demerge TCC in preparation for TCC's listing on the Australian Stock Exchange. The result of the demerger is that Mincor shareholders will hold scrip in both Mincor and TCC, and holders of Mincor Options will hold options to acquire shares in both Mincor and TCC.
12. Upon approval by shareholders of Mincor at General Meeting, the demerger will be conducted by way of a capital reduction and concurrent grant of options by Mincor.
13. The capital reduction will be effected by an in specie distribution of 80% of Mincor's ownership interests (as defined in section 125-60(1) of the ITAA 1997) in TCC to existing Mincor shareholders in the form of TCC Shares.
14. The new options ('TCC Options') granted to the holders of Mincor Options will enable those Mincor option holders to acquire TCC Shares already held by Mincor (i.e. TCC Shares which are not distributed under the demerger).
15. At 31 July 2003, calculations indicate that Mincor shareholders will receive 1 TCC Share for every 4.2806 Mincor Shares held, resulting in a distribution of 40,533,334 TCC Shares. Adjustments to this ratio and distribution will be made based on shareholdings at the date of the demerger. Additionally, in the event that Mincor Options are exercised prior to the demerger date, a need may arise for Mincor to distribute a proportion of the options it holds in TCC to Mincor shareholders, to satisfy the subparagraph 125-70(1)(b)(i) requirement for disposal of at least 80% of its ownership interests in TCC.
16. At 31 July 2003, calculations indicate that holders of Mincor Options will receive 1 TCC Option for every 4.2806 Mincor Options held, resulting in the issue of 2,301,666 TCC Options. Adjustments to this ratio and distribution will be made based on shareholdings at the date of the demerger.
17. No profits in respect of its TCC investment will be recognised in Mincor's accounts in accordance with Australian Accounting Standards. The demerger will not result in a dividend for accounting purposes, and the in specie distribution of TCC Shares, [and options (if required)], calculated as at 31 July 2003 on a weighted average cost per share, will be recorded in Mincor's financial accounts as a return of capital as follows:

DR Share Capital	\$1,730,803.02
CR Investment in TCC	\$1,730,803.02

18. The debit and credit in this journal entry will be equal to Mincor's original cost of the TCC Shares, [and options (if required)], so distributed. No accounting profit will arise from this transaction.
19. Mincor anticipates that the aggregate market value, post-demerger of Mincor and TCC should at least equal the market value of the Mincor Group immediately before the demerger.

Ruling

20. Mincor and its subsidiary TCC constitute a *demerger group* pursuant to subsection 125-65(1) allowing the demerger concessions to be considered.
21. Under the arrangement a demerger happens to the Mincor Group pursuant to section 125-70.
22. When the demerger occurs to transfer Mincor's ownership interests in TCC to Mincor's shareholders, resident shareholders of Mincor will be eligible to elect for roll-over relief to defer Capital Gains Tax ('CGT') consequences for the CGT events that happen to their interests under the demerger pursuant to sub-section 125-55(1).
23. Unless non-resident shareholders who acquire TCC Shares under the demerger obtain at least a 10% beneficial ownership of those TCC shares, they will not be entitled to choose roll-over relief, as the new (TCC) interests acquired will not have the necessary connection with Australia and subsection 125-55(2) will apply (section 136-25, category number 5).
24. Capital gains made by shareholders, being entitled to and choosing roll-over relief in respect of CGT event G1 (section 104-135) happening to their ownership interests in Mincor, will be disregarded under subsection 125-80(1).
25. If a shareholder chooses roll-over relief, then pursuant to subsection 125-80(2), the first element of the cost base and reduced cost base of each TCC Share [and option (if required)] acquired through the demerger is the sum of the cost base of the Mincor Shares acquired on or after 20 September 1985 and prior to the demerger date, apportioned on a reasonable basis having regard to the market values of the remaining original interests and new interests, or a reasonable approximation of the market values of those interests just after the demerger (subsection 125-80(3)).

26. If a shareholder does not choose roll-over relief, then pursuant to subsections 125-85(1) and (2), the same adjustments are made to the first element of the cost base and reduced cost base of each TCC Share acquired pursuant to the demerger and each of the remaining Mincor Shares previously acquired on or after 20 September 1985, as are made pursuant to subsection 125-80(2) for shareholders who have chosen roll-over relief.

27. As a CGT event does not happen in respect of the Mincor Options owned, pursuant to subsections 125-90(1) and (2), the same adjustments are made to the first element of the cost base and reduced cost base of each TCC Option acquired pursuant to the demerger and each of the remaining Mincor Options previously acquired on or after 20 September 1985, as are made pursuant to subsection 125-80(2) for shareholders who have chosen roll-over relief.

28. As none of the shareholders original interests were acquired prior to 20 September 1985, it is unnecessary to consider subsections 125-80(4), 125-80(5), 125-80(6), 125-80(7), 125-80(8).

29. Pursuant to subsection 115-30(1) (Items 1 and 2) for discount capital gains tax calculation purposes, the acquisition date of the TCC Shares [and options (if required)] acquired under the demerger is the date the shareholder originally acquired their Mincor Shares/Options.

30. The dividend arising under the demerger is a *demerger dividend* (subsection 6(1)) and by operation of subsections 44(3) and 44(4), no part of the *demerger dividend* will be assessable as a dividend to shareholders under subsection 44(1). Pursuant to subsection 128B(3D), section 128B will not apply to the *demerger dividend*.

31. The Commissioner will not make a determination under paragraph 45B(3)(a) that section 45BA applies to the whole, or any part, of the *demerger benefit* (subsection 45B(4)) provided to the shareholders under the demerger. Nor will the Commissioner make a determination under paragraph 45B(3)(b) that section 45C applies to the whole, or any part, of the *capital benefit* (subsection 45B(5)) provided to the shareholders under the demerger.

32. The provisions of Part IVA of the ITAA 1936 will not apply to the described arrangement.

Explanation

33. In order for the demerger concessions in Division 125 of the ITAA 1997 to be considered there must be a *demerger group* (subsection 125-65(1)) that 'a demerger happens to' (subsection 125-70(1)).

‘Demerger group’

34. A *demerger group* comprises of one *head entity* and at least one *demerger subsidiary* (subsection 125-65(1)). The demerger group in this case comprises Mincor as head entity and TCC as a demerger subsidiary.

35. Mincor is the *head entity* because:

- TCC doesn’t have ownership interests in Mincor (subsection 125-65(3)); and
- there is no other company that is capable of being a *head entity* having TCC as a *demerger subsidiary* (subsection 125-65(4)).

36. TCC is a *demerger subsidiary* of Mincor because Mincor owns ownership interests that carry more than 20% of the rights to income and capital (subsection 125-65(6)).

37. As Mincor has confirmed that no downstream entities have ownership interests in Mincor, Mincor’s greater than 80% ownership of subsidiary TCC is sufficient for it to be considered a demerger group.

‘Demerger’

38. A *demerger* happens (as per subsections 125-70(1)-(3)) to the Mincor/TCC *demerger group* and the demerger concessions are available as:

- There is a restructuring (paragraph 125-70(1)(a)). Mincor disposes of at least 80% of its existing TCC shares and options to owners of original interests in Mincor (paragraph 125-70(1)(b)(i));
- CGT Event G1 happens to original interests (i.e. Mincor Shares) in the *head entity* [the distribution from Mincor representing a non assessable return of capital would otherwise reduce the original interests (i.e. Mincor Shares) cost base] and those shareholders acquire new interests in TCC and nothing else (subparagraph 125-70(1)(c)(i));
- A CGT Event will not happen to the options held by owners of Mincor Options and those holders of Mincor Options will acquire a new interest in TCC (TCC Options) and nothing else (subparagraph 125-70(1)(c)(ii));

- The arrangement is structured such that the new interests are shares and options to acquire shares in TCC provided on the basis of original interests. This satisfies paragraph 125-70(1)(d) and subparagraph (e)(i);
- Paragraphs 125-70(1)(f) and (g) are satisfied;
- The shares and options in TCC are being distributed/granted to the original shareholders and option holders on the basis of original shareholding/option holding proportions (note: on the basis of the application of the distribution paragraph 125-70(2)(a) will be satisfied);
- the total market value of shareholders/option holders ownership interests in the demerged Mincor and TCC are expected to be reasonably proportionate to their original interests in Mincor (paragraph 125-70(2)(b));
- There is no buy-back involved (subsection 125-70(4)); and
- There is no roll-over available under another provision (subsection 125-70(5)).

‘Employee Share Acquisition Scheme - Interests Disregarded’

39. Ownership interests held by employees through employee share schemes are usually in the form of options that entitle the owner to acquire shares in the company. Under the demerger arrangements it may not be possible to replicate these interests in the demerged entity. Therefore section 125-75 allows an exception to the proportional ownership requirement in subsection 125-70(2) where those interests, taking into account either or both of their number and value, represent no more than 3% of the total ownership interests in the entity.

40. Options issued under the Mincor employee share schemes represent less than 3% of all ownership interests having regard to either or both of their number and value. Therefore, pursuant to subsection 125-75(1), these interests can be disregarded in determining whether a *demerger happens* (subsection 125-70(1)) to the Mincor *demerger group* (subsection 125-65(1)).

‘Foreign Shareholders’

41. Under the terms of the demerger arrangements foreign shareholders of Mincor will receive shares and options in TCC on equal terms with resident shareholders.

‘Roll-over’

42. Original shareholders are eligible to choose roll-over of a capital gain made in a *demerger* in respect of their original shares, if a CGT event happens to those original shares (subsection 125-55(1)). An exception arises pursuant to paragraph 125-55(2) in respect of non-resident shareholders who acquire new interests under a demerger, unless these interests have ‘...the necessary connection with Australia’ (section 136-25). There are two parts to that section which must be satisfied. Part (a) of Category Item 5 requires that the shares acquired in TCC be in an Australian resident public company in the year of acquisition. Part (b) of Category Item 5 applies where a non-resident shareholder and their associates beneficially owned at least 10%, by value of TCC shares at any time in the five years prior to the demerger date. Even though TCC will be an Australian resident public company in the demerger year the factual situation countenanced in Part (b) of Category Item 5 is not anticipated to arise, so the TCC Shares acquired by non-residents will not have the necessary connection with Australia, and roll-over relief will be denied to non-resident shareholders of Mincor.

43. In respect of this demerger, CGT Event G1 applies to the Mincor Shares on the demerger date. CGT event G1 happens if a company makes a payment to a taxpayer in relation to a share the taxpayer owns in the company and some or all of the payment (the non-assessable part) is not a dividend or a liquidator’s distribution that is taken to be a dividend (section 104-135). Therefore, CGT event G1 will apply to the Mincor Shares. In addition, shareholders will receive TCC Shares [and options (if required)] under the demerger and nothing else. Note that in the Mincor-TCC case CGT event G1 is unlikely to give rise to a capital gain because the return of capital is unlikely to exceed the shareholder’s cost base of their Mincor Shares. As such, there is unlikely to be a gain to roll-over (subsection 125-80(1)).

‘Cost Base Adjustments’

44. The method of calculating a new cost base for the original Mincor Shares/options and new TCC Shares [and options (if required)], is the same whether or not roll-over is chosen (subsections 125-80(2) - (3), subsection 125-85(2) and see ‘*Note 1*’ to subsection 125-80(2)).

45. The Mincor shareholders must spread their original cost base of Mincor Shares over the (remaining) Mincor Shares and the new TCC Shares [and options (if required)], on the basis of the relative market values of those shares (subsections 125-80(2) and (3)). To assist apportioning the cost base Mincor intends to provide shareholders with the volume weighted average stock market price (VWAP) on the ASX for Mincor Shares over the 5 day period beginning on the date of the demerger, and a market value for the TCC Shares [and options (if required)], at that time.

‘Demerger Allocation’ and ‘Demerger Dividend’

46. Part 2 of Schedule 16 of the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act No 90 2002*, amended the ITAA 1936 to exempt from tax certain dividends arising under a demerger. Integrity rules limit this exemption where there is a scheme that is entered into for the purpose of obtaining that non-assessable dividend.

47. The *demerger dividend* is that part of the demerger allocation that, but for the operation of subsections 44(3) and (4), would be assessable income to the shareholders of Mincor under subsection 44(1) (subsection 6(1)).

48. The *demerger allocation* is the total market value of the new interests in the demerged entity acquired under the demerger (subsection 6(1)).

49. In the circumstances of this demerger, the *demerger dividend* is the difference between the market value of the TCC Shares [and options (if required)] issued to Mincor shareholders and the distribution, being Mincor’s original cost of its TCC Shares [and options (if required)].

50. Note that, the exemption from tax is not available unless, just after the demerger, at least 50% of the market value of CGT assets owned by the demerged entity or its *demerger subsidiaries* are used in the carrying on of a business by those entities (subsection 44(5)). An analysis of documentation of the to be demerged entity and its subsidiaries as at 30 June 2003 indicates that this requirement will be satisfied.

‘Section 45B - Schemes to provide certain benefits’

51. Section 45B 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 a demerger; or
- (b) certain payments, allocations and distributions are made in substitution for dividends.

52. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a *demerger benefit* or *capital benefit* by a company (paragraph 45B(2)(a));
- under the scheme a taxpayer, who may or may not be the person provided with the *demerger benefit* or the *capital benefit*, obtains a *tax benefit* (paragraph 45B(2)(b)); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

53. The provision of ownership interests in a company, a distribution or the doing of a thing in relation to an ownership interest that has the effect of increasing the value of an ownership interest owned by the person which occurs under a demerger may be considered to be a *demerger benefit* and a *capital benefit* for the purposes of section 45B (subsections 45B(4) and (5)). However, if the provision of interests, the distribution or the thing done involves the person receiving a *demerger dividend* then, to that extent, it cannot be treated as a *capital benefit* (subsection 45B(6)). Accordingly, to the extent that the *demerger benefit* does not involve the receipt of a *demerger dividend* it will constitute both a *demerger benefit* and a *capital benefit*.

54. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) are met, the requisite purpose of enabling the Mincor shareholders to obtain a *tax benefit* (by way of a *demerger benefit* or a *capital benefit*) is not present. In other words, having regard to the relevant circumstances of the scheme, set out in subsection 45B(8), it would not be concluded that any of the parties to the demerger entered into or carried out the scheme to obtain a *tax benefit* in the form of a *demerger benefit* or a *capital benefit*.

55. It is apparent that the *demerger benefit* and *capital benefit* provided to the Mincor shareholders reflect the circumstances of the demerger. In this regard, it is considered that the attribution of the *demerger benefit* between capital and dividend is reasonable. Also, the capital benefit provided cannot be said to be attributable to the profits of the company, nor does Mincor's pattern of distributions indicate that it is being paid in substitution for a dividend. Furthermore, although the tax result for participating shareholders is favourable, there is nothing known of the circumstances of the Mincor shareholders to indicate that the demerger was structured to provide *tax benefits*. Accordingly, in this case the relevant circumstances outlined in paragraphs 45B(8)(c) to (g) do not incline for or against the relevant conclusion as to purpose.

Detailed contents list

56. Below is a detailed contents list for this Class Ruling:

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Commissioner of Taxation

13 August 2003

Previous draft:

Not previously released in draft form.

*Related Rulings/Determinations:*TR 92/1; TR 92/20; TR 97/16;
CR 2001/1*Subject references:*

- capital benefit
- capital gains
- cost base adjustments
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- demerger dividend
- demerger subsidiary
- demerger group
- employee share acquisition scheme
- non-resident shareholders
- return of capital
- roll-over
- schemes to provide certain benefits

Legislative references:

- ITAA 1936 Pt IVA
- ITAA 1936 6(1)
- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 44(5)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)(a)
- ITAA 1936 45B(3)(b)
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- ITAA 1936 45B(6)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(c)
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- TAA 1953 Pt IVAAA

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- ITAA 1997 125-55(2)(b)
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- ITAA 1997 125-65(3)
- ITAA 1997 125-65(4)
- ITAA 1997 125-65(6)
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- ITAA 1997 125-80(7)
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- ITAA 1997 125-85(2)
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- ITAA 1997 125-90(2)
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- ITAA 1997 136-25
- Copyright Act 1968
- Corporations Act 1989
- New Business Tax System Consolidation, Value Shifting, Demergers and Other Measures) No 90 of Act 2002

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