



CR 2004/108 - Income tax: capital gains: demerger of Austin Engineering Ltd by West Australian Metals Ltd

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Class Ruling

Income tax: capital gains: demerger of Austin Engineering Ltd by West Australian Metals Ltd

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Preamble

*The number, subject heading, **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 laws 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;
- Part IVA of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- subsection 115-30(1) of the ITAA 1997; and
- Division 125 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the Australian resident ordinary shareholders of West Australian Metals Ltd (WAM) who were registered as ordinary shareholders (WAM shareholders) on the date of the demerger (their shares are referred to as WAM Shares) of Austin Engineering Pty Ltd (Austin).

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 of this Ruling.

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

- 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
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies to the year of income ended 30 June 2004 or substituted accounting period. 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 1 July 2004. The Ruling continues to apply to those members of the class of persons who participated in the demerger which happened on 8 December 2003.

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 16 December 2003 from Blake Dawson Waldron (BDW) requesting the issue of a Class Ruling, under section 14ZAAF of the *Tax Administration Act 1953*, together with Explanatory Statement attached to Notice of Annual General Meeting of WAM held on 28 November 2003;
- Letters dated 31 March and 13 July 2004 from BDW; and
- Facsimile dated 15 September 2004 from BDW.

Note: certain information received from BDW on behalf of WAM may have been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

11. WAM acquired the business of Austin in November 2002, through WAM's wholly owned subsidiary Seinson Pty Ltd (Seinson). On 28 November 2003, Seinson changed its status to that of a public company limited by shares, and changed its name to Austin Engineering Ltd. The company was subsequently listed on the ASX.

12. Following approval by shareholders of WAM at General Meeting held on 28 November 2003, the demerger occurred by way of a capital reduction. The demerger happened on 8 December 2003.

13. The capital reduction was effected by an in specie distribution of WAM's ownership interests in Austin to the WAM shareholders. The Austin shares represented approximately 14.591% of the value of WAM on the demerger date.

14. The result of the demerger is that WAM shareholders own shares in both WAM and Austin. WAM shareholders received two Austin shares for every nine WAM shares owned.

15. WAM had on issue 3,250,000 unlisted options which were qualifying rights acquired under an employee share scheme. Just before the demerger, those options represented not more than 3% of the total ownership interests in WAM, taking into account either or both their number and value.

16. WAM also had on issue listed options representing not more than 10% of the ownership interests in WAM taking into account their value.

17. Option holders were not granted any ownership interests in Austin, but the exercise price of each option was reduced by the amount of the return of capital on each fully paid share.

18. No profits in respect of its shares in Austin were recognised in WAM's accounts. The demerger did not result in a dividend for accounting purposes, and the in specie distribution of the Austin shares was recorded in WAM's financial accounts as a return of capital.

19. The amount of the capital reduction was \$819,392, which is equivalent to approximately 0.8 cents per share based on the issued capital of 99,925,823 WAM shares.

Ruling

20. WAM and its subsidiary Austin constitute a demerger group under subsection 125-65(1) of the ITAA 1997.

21. A demerger happened to the WAM group under section 125-70 of the ITAA 1997.

22. WAM shareholders are eligible to choose roll-over relief to defer capital gains tax (CGT) consequences for the CGT events that happen to their WAM shares under the demerger under subsection 125-55(1) of the ITAA 1997.

23. Capital gains or losses made by WAM shareholders who choose roll-over relief in respect of CGT event G1 (section 104-135 of the ITAA 1997) happening to their WAM shares will be disregarded under subsection 125-80(1) of the ITAA 1997.

24. If a shareholder chooses roll-over relief, under subsection 125-80(2) of the ITAA 1997, the first element of the cost base and reduced cost base of each WAM share acquired on or after 20 September 1985 and before the demerger date (post-CGT WAM shares) and the corresponding Austin shares acquired under the demerger is the sum of the cost base of the post-CGT WAM shares, 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) of the ITAA 1997).

25. If a shareholder does not choose roll-over relief, the same adjustments are made under subsections 125-85(1) and (2), to the first element of the cost base and reduced cost base of each post-CGT WAM share and the corresponding Austin share acquired under the demerger, as would be made if those shareholders had chosen roll-over relief under section 125-80 of the ITAA 1997.

26. WAM shareholders who choose roll-over and who acquired some or all of their WAM shares before 20 September 1985 will be taken to have acquired a corresponding number of their Austin shares before that day.

27. Under subsection 115-30(1) of the ITAA 1997 (Item 2) for discount capital gains tax calculation purposes, the acquisition date of the Austin shares acquired under the demerger is the date each shareholder acquired their WAM shares.

28. The dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936) and by operation of subsections 44(3) and 44(4) of the ITAA 1936, no part of the demerger dividend will be assessable as a dividend to WAM shareholders under subsection 44(1).

29. Neither section 45BA nor section 45C of the ITAA 1936 applies to the demerger benefit or capital benefit, respectively, that is provided to WAM shareholders under the demerger.

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

Explanation

31. 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) of the ITAA 1997).

Demerger group

32. A demerger group (WAM/Austin demerger group) comprises one head entity and at least one demerger subsidiary (subsection 125-65(1) of the ITAA 1997). The demerger group in this case comprises WAM as head entity and Austin as its demerger subsidiary.

33. WAM is the head entity because:

- Austin has no ownership interests in WAM (subsection 125-65(3) of the ITAA 1997); and
- there is no other entity that is capable of being a head entity having Austin as a demerger subsidiary (subsection 125-65(4) of the ITAA 1997).

34. Austin is a demerger subsidiary of WAM because WAM owns ownership interests in Austin that carry more than 20% of the rights to income and capital (subsection 125-65(6) of the ITAA 1997).

Demerger

35. A demerger (subsections 125-70(1) to (3) of the ITAA 1997) happens to the WAM/Austin demerger group and the demerger concessions are available as:

- there is a restructuring (paragraph 125-70(1)(a) of the ITAA 1997), and WAM disposes of at least 80% of its Austin shares to owners of original interests in WAM (paragraph 125-70(1)(b)(i));
- CGT Event G1 happens to original interests (WAM shares) in the head entity and the WAM shareholders acquire new shares in Austin and nothing else (subparagraph 125-70(1)(c)(i) of the ITAA 1997);
- the arrangement is structured such that the Austin shares are provided on the basis of ownership of the original interests in WAM. This satisfies paragraph 125-70(1)(d) and subparagraph 125-70(1)(e)(i) of the ITAA 1997;
- paragraphs 125-70(1)(f) and (g) of the ITAA 1997 are satisfied;
- the Austin shares were distributed to the WAM shareholders on the basis of their original shareholdings and the requirements of paragraph 125-70(2)(a), together with section 125-75, of the ITAA 1997 are satisfied;
- the total market value of the shares in each of WAM and Austin just after the demerger were expected to be reasonably proportionate to the market value of the WAM shares before the demerger (paragraph 125-70(2)(b) of the ITAA 1997);
- there is no share buy-back involved (subsection 125-70(4) of the ITAA 1997); and
- there is no roll-over available under another provision of the tax law (subsection 125-70(5) of the ITAA 1997).

36. CGT Event G1 happens to the WAM shares on the demerger date. It is unlikely that a capital gain will arise upon the happening of the G1 event because the return of capital is unlikely to exceed the cost bases of the WAM shareholders. As such, there is unlikely to be a capital gain to roll-over (subsection 125-80(1) of the ITAA 1997).

Cost base adjustments

37. The method of calculating a new cost base for the original WAM shares and new Austin shares is the same whether or not roll-over is chosen (subsections 125-80(2) and (3), subsection 125-85(2) and see 'Note 1' to subsection 125-80(2) of the ITAA 1997).

38. The WAM shareholders must spread their original cost base for their WAM shares over their WAM shares and the new Austin shares, on the basis of the relative market values of those shares (subsections 125-80(2) and (3) of the ITAA 1997). WAM has advised that the apportionment should be done on the basis that Austin represents 14.591% of the value of WAM at the time of the demerger.

Demerger allocation and demerger dividend

39. The demerger measure exempts 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 (demerger dividend).

40. 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 of the WAM shareholders under subsection 44(1) (subsection 6(1) of the ITAA 1936). The demerger allocation is the total market value of the new interests in the demerged entity acquired under the demerger (subsection 6(1)).

41. In the circumstances of this demerger, the demerger dividend is the difference between the market value of the Austin shares distributed to WAM shareholders and the cost of WAM's Austin shares.

42. More than 50% of the market value of the CGT assets owned by Austin or its demerger subsidiaries are used in the carrying on of a business by those entities (subsection 44(5) of the ITAA 1936).

Section 45B

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

44. 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)).

45. 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.

46. In this case, the requisite purpose of enabling the WAM 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), the parties to the demerger did not enter into or carry out the scheme to obtain a tax benefit in the form of a demerger benefit or a capital benefit.

47. It is apparent that the demerger benefit and capital benefit provided to the WAM shareholders reflect the circumstances of the demerger. In this regard, it is considered that the attribution of the demerger benefit to capital is reasonable. Also, the capital benefit provided cannot be said to be attributable to the profits of the company, nor does WAM'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 WAM 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.

48. In coming to the conclusion, for the purposes of section 45B of the ITAA 1936, that the parties to the demerger did not enter into or carry out the demerger for a more than incidental purpose of enabling the WAM shareholders of obtaining a tax benefit, it is also concluded that the essential purpose for their participation in the demerger was to improve business performance. The delivery of tax benefits is merely an incidental aspect of a commercially driven scheme.

Accordingly, for the purposes of Part IVA of the ITAA 1936, in particular section 177D of the ITAA 1936, it would not be concluded that the demerger scheme was entered into for the dominant purpose of enabling WAM shareholders to obtain a tax benefit.

Detailed contents list

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Commissioner of Taxation

6 October 2004

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 97/16

Subject references:

- capital benefit
- capital gains
- cost base adjustments
- demerger

- demerger allocation

- demerger benefit
- demerger dividend
- demerger subsidiary
- demerger group
- return of capital
- roll-over

- schemes to provide certain benefits

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44

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- 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(4)
 - ITAA 1936 45B(5)
 - ITAA 1936 45B(6)
 - ITAA 1936 45B(8)
 - ITAA 1936 45B(8)(c)
 - ITAA 1936 45B(8)(d)
 - ITAA 1936 45B(8)(e)
 - ITAA 1936 45B(8)(f)
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 - ITAA 1936 Pt IVA
 - ITAA 1936 177D
 - ITAA 1997 104-135
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-65(1)
 - ITAA 1997 125-65(3)
 - ITAA 1997 125-65(4)
 - ITAA 1997 125-65(6)
 - ITAA 1997 125-70
 - ITAA 1997 125-70(1)
 - ITAA 1997 125-70(1)(a)
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 - ITAA 1997 125-70(3)
 - ITAA 1997 125-70(4)
 - ITAA 1997 125-70(5)
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