



CR 2004/128 - Income tax: capital gains: roll-over relief for shareholders: demerger of Leviathan Resources Limited by MPI Mines Ltd

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Class Ruling

Income tax: capital gains: roll-over relief for shareholders: demerger of Leviathan Resources Limited by MPI Mines 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 laws' 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;
- 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 whom this Ruling applies is the ordinary shareholders of MPI Mines Ltd (MPI) who:
- (a) are 'residents of Australia' (as that term is defined in subsection 6(1) of the ITAA 1936) at the time of the demerger;
 - (b) participate in the arrangement that is the subject of this Ruling; and
 - (c) hold their MPI shares on capital account.

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 17.
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 both before and after its date of issue to all persons within the specified class who enter into the arrangement ruled on. 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 immediately after 30 June 2005. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the arrangement during the term of the Ruling.

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 August 2004 from PriceWaterhouseCoopers (PwC) requesting the issue of a Class Ruling;
- letters dated 21 and 28 September 2004 from PwC; and
- e-mails dated 20 October and 8 November 2004 from PwC.

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. MPI owns 100% of the issued shares in Leviathan Resources Limited (Leviathan Resources).

12. MPI intends to demerge Leviathan Resources in preparation for Leviathan Resources' listing on the ASX. The result of the demerger is that MPI shareholders will hold shares in MPI and in Leviathan Resources.

13. Upon approval by MPI shareholders at general meeting, the demerger will be conducted by way of a capital reduction, effected by an in specie distribution of 100% of MPI's shares in Leviathan Resources to existing MPI shareholders. MPI will debit the capital distribution against the amount standing to the credit of its share capital account.

14. MPI shareholders will receive one share in Leviathan Resources for every three MPI shares based on their shareholdings at the date of the demerger.

15. None of the MPI shares were acquired by MPI shareholders before 20 September 1985.

16. MPI has options issued under the MPI employee share scheme(s) which represent less than 3% of all ownership interests in MPI measured by either or both of their number and value.

17. MPI has advised that at least 50% of the market value of CGT assets owned by Leviathan Resources and its demerger subsidiaries is used in the carrying on of a business by those entities.

Ruling

18. CGT event G1 in section 104-135 of the ITAA 1997 will happen when MPI distributes the Leviathan Resources shares that it owns to MPI shareholders.

19. MPI shareholders can choose demerger roll-over under Division 125 when CGT event G1 happens to their MPI shares (subsection 125-55(1) of the ITAA 1997)

20. If demerger rollover is chosen, any capital gain from CGT event G1 happening to a MPI share is disregarded (subsection 125-80(1)).

21. Regardless of whether they choose rollover, MPI shareholders must calculate a new first element of the cost base and reduced cost base (just after the demerger) of:

- their MPI shares; and
- the new Leviathan Resources shares received in relation to those MPI shares,

(sections 125-80 and 125-85 of the ITAA 1997).

22. A MPI shareholder can, for discount capital gains tax purposes, treat the Leviathan Resources shares acquired under the demerger as having been acquired on the date they acquired their corresponding MPI share (item 2 in the table in subsection 115-30(1) of the ITAA 1997).

23. Any dividend arising under the demerger is a *demerger dividend* and is neither assessable income nor exempt income of the MPI shareholders (subsections 6(1), 44(3) and 44(4) of the ITAA 1936).

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

Explanation

CGT event G1

25. CGT event G1 in section 104-135 of the ITAA 1997 happens if a company makes a payment to a shareholder, in respect of their shares in the company, where some or all of the payment is not a dividend or an amount that is taken to be a dividend under section 47 of the ITAA 1936 (non-assessable payment). The payment can include the giving of property (section 103-5 of the ITAA 1997).

26. If CGT event G1 happens during an income year, a shareholder will make a capital gain if the total of the non-assessable payments made by the company during the income year in relation to a share exceeds the cost base of the share.

27. CGT event G1 will happen when the Leviathan Resources shares are distributed to the MPI shareholders because part or all of the value of the distribution represents a return of capital which is neither a dividend nor an amount taken to be a dividend under section 47 of the ITAA 1936.

28. MPI shareholders who make a capital gain from CGT event G1 happening to their MPI shares may choose roll-over (see paragraphs 29 to 30 of this Ruling) to disregard the capital gain (subsection 125-80(1) of the ITAA 1997).

Demerger relief

29. Subsection 125-55(1) of the ITAA 1997 provides that roll-over may be chosen if:

- a shareholder owns a share in a company – this requirement is satisfied as MPI shareholders own shares in MPI;
- the company is the head entity of a demerger group – this requirement is satisfied as MPI is the head entity of a demerger group (refer to paragraphs 31 to 33 of this Ruling);
- a demerger happens to the demerger group – this requirement is satisfied as a demerger happens to the MPI/Leviathan Resources demerger group (refer to paragraph 34 of this Ruling); and
- under the demerger a CGT event happens to the original interest (MPI shares) and a new or replacement interest is acquired in the demerged entity – this requirement is satisfied as CGT event G1 happens to the MPI shares (refer to paragraph 27 of this Ruling) and MPI shareholders receive Leviathan Resources shares under the demerger and nothing else.

30. Therefore MPI shareholders can choose roll-over for the demerger.

Is MPI the head entity of a demerger group?

31. A 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 MPI as head entity and Leviathan Resources as a demerger subsidiary (MPI/Leviathan Resources demerger group).

32. MPI is the head entity because:

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

33. Leviathan Resources is a demerger subsidiary of MPI because MPI owns ownership interests that carry the right to receive more than 20% of any distribution of income or capital by Leviathan Resources and the right to exercise more than 20% of the voting power in Leviathan Resources (subsection 125-65(6) of the ITAA 1997).

Has a demerger happened to the demerger group?

34. A demerger happens (in accordance with subsections 125-70(1), (2) and (3) of the ITAA 1997) to the MPI/Leviathan Resources demerger group because:

- there is a restructuring (paragraph 125-70(1)(a)), and MPI disposes of at least 80% of its existing Leviathan Resources shares to owners of original shares in MPI (subparagraph 125-70(1)(b)(i));
- CGT event G1 happens to MPI shares and MPI shareholders acquire new shares in Leviathan Resources and nothing else (subparagraph 125-70(1)(c)(i));
- under the restructure Leviathan Resources shares are acquired by MPI shareholders on the basis of their ownership of their shares in MPI (paragraph 125-70(1)(d) and subparagraph 125-70(1)(e)(i));
- paragraphs 125-70(1)(f) and 125-70(1)(g) are satisfied;
- MPI shareholders will acquire Leviathan Resources shares in the same proportion as they owned MPI shares just before the demerger (paragraph 125-70(2)(a));

- the total market value of the shares in each of MPI and Leviathan Resources after the demerger is expected to be reasonably proportionate to the total market value of the MPI shares before the demerger (paragraph 125-70(2)(b));
- options issued under the MPI employee share schemes can be disregarded in determining whether the requirements of subsection 125-70(2) are met (subsections 125-75(1) and (2));
- there is no buy-back involved (subsection 125-70(4)); and
- there is no roll-over available under another provision (subsection 125-70(5)).

Demerged entity

35. An entity that is a former member of a demerger group is a *demerged entity* if, under a demerger that happens to the group, ownership interests in it are acquired by shareholders in the head entity of the group (subsection 125-70(6) of the ITAA 1997).

36. Leviathan Resources is a *demerged entity* because shares in it are acquired by MPI shareholders (MPI being the head entity of the MPI/Leviathan Resources demerger group).

Cost base adjustments

37. The method of calculating the first element of the cost base and reduced cost base for a shareholder's original MPI shares and new Leviathan Resources shares is the same whether or not roll-over is chosen (subsections 125-80(2) and (3) of the ITAA 1997, subsection 125-85(2) and refer to Note 1 to subsection 125-80(2)).

38. MPI shareholders must apportion their total original cost base for their MPI shares over their MPI shares and the corresponding new Leviathan Resources shares, on the basis of the relative market values of those shares (subsections 125-80(2) and (3) of the ITAA 1997). MPI intends to provide MPI shareholders with information to calculate the cost base adjustments as soon as possible after the demerger.

Time of acquisition of Leviathan Resources shares – CGT discount

39. For general capital gains tax purposes, shareholders will acquire their Leviathan Resources shares when those shares are received under the demerger (section 109-10 of the ITAA 1997). However, for the purpose of accessing the CGT discount in Division 115 of the ITAA 1997, Leviathan Resources shareholders will be taken to have acquired their Leviathan Resources shares on the date they acquired their corresponding MPI shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). One of the conditions that must be satisfied before a capital gain can be reduced by the

discount percentage is that it relate to an asset that was owned for at least 12 months (subsection 115-25(1) of the ITAA 1997).

Demerger dividend

40. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income a dividend, as defined in subsection 6(1) of the ITAA 1936, paid to a shareholder out of company profits.

41. The subsection 6(1) of the ITAA 1936 definition of a dividend includes any distribution made by a company to any of its shareholders. However, paragraph (d) of that definition excludes amounts debited against an amount standing to the credit of the share capital account of the company.

42. In the circumstances of this demerger, MPI will debit the capital distribution against the amount standing to the credit of the 'share capital account', as defined in section 6D of the ITAA 1936. That amount will therefore not constitute a dividend for the purposes of subsection 6(1) of the ITAA 1936 and will not be assessable as a subsection 6(1) dividend under subsection 44(1) of the ITAA 1936.

43. However, if the value of the Leviathan Resources shares distributed under the demerger exceeds the amount debited against the share capital account, a dividend will arise (see Taxation Ruling TR 2003/8). Subject to the integrity rules in section 45B of the ITAA 1936 (see paragraph 44 to 48), this dividend is neither an assessable dividend nor an exempt income amount of the MPI shareholders (subsections 44(3) and (4) of the ITAA 1936) because:

- the dividend amount is a *demerger dividend* (as defined in subsection 6(1) of the ITAA 1936);
- MPI will not make an election that subsections 44(3) and (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.

Section 45B – schemes to provide certain benefits

44. Section 45B of the ITAA 1936 applies to ensure that relevant amounts are treated as dividends for taxation purposes if:

- components of a *demerger allocation* as between capital and profit do not reflect the circumstances of a demerger; or
- certain payments, allocations and distributions are made in substitution for dividends.

45. 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) of the ITAA 1936);

- 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) of the ITAA 1936); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, 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) of the ITAA 1936).

46. 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 of the ITAA 1936 (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*.

47. In this case, while the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are met, the requisite purpose of enabling the MPI 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*.

48. It is apparent that the *demerger benefit* and *capital benefit* provided to the MPI shareholders reflect the circumstances of the demerger. In this regard, it is considered that the attribution of the *demerger benefit* between capital and profit is reasonable. Also, the capital benefit provided cannot be said to be attributable to the profits of the company, nor does MPI'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 MPI shareholders to indicate that the demerger was structured to provide *tax benefits*.

Detailed contents list

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Commissioner of Taxation

17 November 2004

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 97/16; TR 2003/8

Subject references:

- | | |
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| - capital benefit | - demerger |
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| | - return of capital |
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| | - schemes to provide certain |
| | benefits |

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- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 44(2)
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 44(5)
- ITAA 1936 45B
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- ITAA 1936 45B(2)(c)
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- ITAA 1936 45B(3)(b)
- ITAA 1936 45B(4)
- ITAA 1936 45B(5)
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- ITAA 1997 109-10
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- ITAA 1997 125-65(3)
- ITAA 1997 125-65(4)
- ITAA 1997 125-65(6)
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