

CR 2005/74 - Income tax: capital gains: demerger of Progressive Enterprises Holdings Limited by Foodland Associated Limited

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Class Ruling

Income tax: capital gains: demerger of Progressive Enterprises Holdings Limited by Foodland Associated Limited

Contents	Para
What this Class Ruling is about	1
Date of effect	8
Withdrawal	9
Arrangement	10
Ruling	28
Explanation	35
Detailed contents list	60

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:

- section 44 of the *Income Tax Assessment Act 1936* (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); and
- Division 125 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the ordinary shareholders of Foodland Associated Limited (FAL) who:

- (a) hold their FAL shares on capital account; and
- (b) are 'residents of Australia' within the meaning of that expression in subsection 6(1) of the ITAA 1936 at the time 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 27.
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 - this Ruling may be withdrawn or modified.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 2006 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 immediately after 30 June 2006. 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 and includes reference to the following documents:

- (a) Class Ruling application dated 17 August 2005 from Ernst & Young requesting the Commissioner make a Class Ruling in relation to the demerger of FAL's New Zealand Business via a capital reduction and demerger dividend to FAL shareholders;
- (b) FAL Press Release of 25 May 2005 and Metcash Limited (Metcash) and Woolworths Limited (WOW) Press Releases of 30 May 2005;
- (c) draft Demerger Implementation Deed dated 8 August 2005;
- (d) draft Demerger Deed dated 17 June 2005;
- (e) draft FAL Scheme Booklet dated 8 August 2005; and
- (f) e-mails from Ernst & Young from 15 June 2005 to 13 September 2005.

Note 1: Certain information received from Ernst & Young has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

Note 2: Certain key terms contained in this Ruling are defined in the table in Appendix A.

11. The arrangement that is the subject of this Ruling involves the demerger of FAL's New Zealand business assets.

12. The arrangement is part of a proposal announced by FAL on 25 May 2005. The proposal involves the acquisition of FAL's Australian business assets (excluding Australian Woolworths Action Stores) by Metcash and the acquisition of FAL's New Zealand business assets and Australian Woolworths Action Stores by WOW.

13. The acquisitions will occur through the implementation of two schemes of arrangement; the Demerger Scheme and the Transfer Scheme.

The Demerger Scheme

14. The business assets of FAL will be divided as follows:

- (a) Progressive Enterprises Holdings Limited (PEH) (a recently incorporated wholly owned subsidiary of FAL) will acquire FAL's New Zealand business assets; and
- (b) FAL will hold the Australian business assets.

15. PEH shares will be transferred from FAL to FAL shareholders to effect the demerger.

The Transfer Scheme

16. Immediately following the demerger, it is proposed that:
- (a) PEH shares will be transferred to the WOW Group; and
 - (b) FAL shares will be transferred to the Metcash Group.
17. The transfer of PEH to the WOW Group and the transfer of FAL to the Metcash Group are to be implemented under one scheme of arrangement (the Transfer Scheme). The transfers to the WOW Group and the Metcash Group cannot occur separately.
18. If the Transfer Scheme is approved by FAL shareholders, the demerged business assets acquired by PEH and transferred to the WOW Group will include Australian Woolworths Action Stores. If the Transfer Scheme is not approved, the demerged business assets acquired by PEH will not include Australian Woolworths Action Stores.
19. The Transfer Scheme is conditional upon approval by FAL shareholders of the Demerger Scheme. The Demerger Scheme is not conditional upon approval of the Transfer Scheme. Both schemes require approval by the Court.
20. The Transfer Scheme where PEH shares are transferred to the WOW Group and FAL shares are transferred to the Metcash Group is the subject of Class Rulings CR 2005/76 and CR 2005/75 respectively.

Features of the Demerger Scheme

21. On the Demerger Implementation Date (expected to be 24 November 2005):
- the share capital of FAL will be reduced by the Capital Reduction amount;
 - FAL will pay the Demerger Dividend;
 - each FAL shareholder on the Demerger Record Date (expected to be 17 November 2005) will be entitled to receive one PEH share for every FAL share they hold; and
 - FAL shareholders who are entitled to receive PEH shares under the Demerger Scheme will automatically have their entitlement to the amount of the Capital Reduction and the Demerger Dividend applied to pay for the transfer of the PEH shares.
22. If the Transfer Scheme is not approved, FAL or an agent for FAL will sell the PEH shares to which the ineligible overseas shareholders will become entitled under the Demerger Scheme and remit the average net proceeds of sale to each ineligible overseas shareholder.

23. If the Transfer Scheme is approved the PEH shares to which an ineligible overseas shareholder will become entitled under the Demerger Scheme will be transferred to WOW (NZ) Supermarkets Limited (a wholly-owned subsidiary of WOW) in accordance with the terms of the Transfer Scheme.

24. An ineligible overseas shareholder is a FAL shareholder whose address, as shown on the register of members of FAL, is not in Australia or New Zealand.

25. The capital reduction and the demerger dividend will together be an amount equivalent to the value of PEH. FAL will debit its share capital account to the extent of the capital reduction (approximately \$485 million) and retained earnings to the extent of the demerger dividend. On this basis the demerger will involve a return of capital of \$4.12 per share (based on the 117,828,603 shares currently on issue).

26. FAL has advised that at least 50% of the market value of capital gains tax (CGT) assets owned by PEH and its demerger subsidiaries will be used in the carrying on of a business by those entities.

Implementation of the Demerger Scheme

27. Certain approvals are required for implementing the Demerger Scheme:

- the demerger and capital reduction must be approved by FAL shareholders at the Demerger Scheme meeting (expected to be held on 2 November 2005);
- the Demerger Scheme must be Court approved; and
- if the Transfer Scheme is not approved, the Australian Stock Exchange (ASX) must approve the admission of PEH to the official list of the ASX.

Ruling

CGT event G1

28. CGT event G1 (section 104-135 of the ITAA 1997) will happen to each of the shares of the FAL shareholders at the time of the capital reduction.

Demerger roll-over relief

29. FAL shareholders will be eligible to choose roll-over relief under subsection 125-55(1) of the ITAA 1997, in order to defer the CGT consequences for CGT event G1 that happens to their FAL shares under the demerger. For FAL shareholders who choose roll-over relief, any capital gain made in respect of CGT event G1 that happens to their FAL shares will be disregarded under subsection 125-80(1) of the ITAA 1997.

Consequences of roll-over relief

30. If a shareholder chooses roll-over relief the first element of the cost base and reduced cost base of each FAL share acquired before the demerger date, and the corresponding PEH shares acquired under the demerger, will be the sum of the cost bases of the FAL 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 (subsections 125-80(2) and (3) of the ITAA 1997).

31. If a shareholder does not choose roll-over relief, the same adjustments as would be made if that shareholder had chosen roll-over relief are made to the first element of the cost base and reduced cost base of each FAL share and the corresponding PEH share acquired under the demerger (subsections 125-85(1) and (2) of the ITAA 1997).

32. FAL shareholders who choose roll-over and who acquired some or all of their FAL shares before 20 September 1985 will be taken to have acquired a corresponding number of their PEH shares before that day (subsections 125-80(5) and (6) of the ITAA 1997).

Demerger allocation and demerger dividend

33. Any dividend arising under the demerger will be 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 FAL shareholders under subsection 44(1) of the ITAA 1936.

34. 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 FAL shareholders under the demerger. 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 FAL shareholders under the demerger.

Explanation

CGT event G1

35. CGT event G1 (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 and some or all of that 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).

36. If CGT event G1 happens, a shareholder will make a capital gain if the non-assessable payment made by the company in relation to a share exceeds the cost base of the share (subsection 104-135(3) of the ITAA 1997).

37. CGT event G1 will happen at the time of the capital reduction (subsection 104-135(2) of the ITAA 1997). A capital gain will arise if the capital reduction of \$4.12 exceeds the cost base of the FAL share at that time.

38. FAL shareholders who make a capital gain from the CGT event G1 that happens to their FAL shares may choose demerger roll-over relief (section 125-55 of the ITAA 1997) in order to disregard this capital gain (subsection 125-80(1) of the ITAA 1997).

Demerger roll-over relief

39. 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 FAL shareholders own shares in FAL;
- the company is the head entity of a demerger group – this requirement is satisfied as FAL is the head entity of a demerger group (refer to paragraphs 41 to 43 of this Ruling);
- a demerger happens to the demerger group – this requirement is satisfied as a demerger happens to the FAL/PEH demerger group (refer to paragraphs 44 to 45 of this Ruling); and
- under the demerger a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity – this requirement is satisfied as CGT event G1 happens to the FAL shares (refer to paragraph 37 of this Ruling) and FAL shareholders receive PEH shares under the demerger and nothing else.

40. Therefore, FAL shareholders may choose roll-over relief for the demerger.

Is FAL the head entity of a demerger group?

41. 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 FAL as head entity and PEH as a demerger subsidiary (FAL/PEH demerger group).

42. FAL is the head entity because:

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

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

Has a demerger happened to the demerger group?

44. A demerger happens (subsections 125-70(1), (2) and (3) of the ITAA 1997) to the FAL/PEH demerger group because:

- there is a restructuring (paragraph 125-70(1)(a)), and FAL disposes of at least 80% of its existing PEH shares to owners of original shares in FAL (subparagraph 125-70(1)(b)(i));
- CGT event G1 happens to FAL shares and FAL shareholders acquire new shares in PEH and nothing else (subparagraph 125-70(1)(c)(i));
- under the restructure, PEH shares are acquired by FAL shareholders on the basis of their ownership of their shares in FAL (paragraph 125-70(1)(d) and subparagraph 125-70(1)(e)(i));
- paragraphs 125-70(1)(f) and 125-70(1)(g) are satisfied;
- FAL shareholders will acquire PEH shares in the same proportion as they owned FAL shares just before the demerger (paragraph 125-70(2)(a));
- the total market value of the shares in each of FAL and PEH after the demerger is expected to be reasonably proportionate to the total market value of the FAL shares before the demerger (paragraph 125-70(2)(b)); and
- subsections 125-70(4) and (5) are not applicable.

45. Ineligible overseas shareholders of FAL will be entitled to receive shares in PEH on equal terms with resident shareholders. The fact that the shares received by ineligible overseas shareholders may immediately be disposed of, will not result in the failure of the proportion test in subsection 125-70(2) of the ITAA 1997.

Consequences of roll-over relief

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

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

48. FAL shareholders who choose roll-over and who acquired some or all of their FAL shares before 20 September 1985 will be taken to have acquired a corresponding number of their PEH shares before that day (subsections 125-80(5) and (6) of the ITAA 1997).

Time of acquisition of PEH shares – CGT discount

49. Before a capital gain can be reduced by the CGT discount, one of the conditions that must be satisfied is that the capital gain relates to an asset that was owned for at least 12 months (subsection 115-25(1) of the ITAA 1997). For CGT purposes, shareholders will acquire their PEH 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, PEH shareholders will be taken to have acquired their PEH shares on the date they acquired their corresponding FAL shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997).

Demerger allocation and demerger dividend

50. 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).

51. The demerger dividend is that part of the demerger allocation that, but for the operation of subsections 44(3) and 44(4) of the ITAA 1936, would be assessable income of the FAL shareholders under subsection 44(1) of the ITAA 1936 (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) of the ITAA 1936).

52. In the circumstances of this demerger, FAL 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.

53. However, if the value of the PEH 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 paragraphs 54 to 58), this dividend is neither an assessable dividend nor an exempt income amount of the FAL shareholders (subsections 44(3) and 44(4) of the ITAA 1936) because:

- the dividend amount is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936);
- FAL will not make an election 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 because more than 50% of the market value of the CGT assets owned by PEH will be used in carrying on of a business by PEH.

Section 45B – schemes to provide certain benefits

54. 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.

55. 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, 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) of the ITAA 1936).

56. A demerger is a 'scheme' within the broad meaning of that term (subsection 45B(10) of the ITAA 1936).

57. The provision of ownership interests to a shareholder under a demerger constitutes their being provided with a demerger benefit (subsection 45B(4) of the ITAA 1936) and a capital benefit (subsection 45B(5) of the ITAA 1936) to the extent that the demerger benefit is not a demerger dividend (subsection 45B(6) of the ITAA 1936). Furthermore, as the tax payable on a demerger benefit and a capital benefit is less than it would be if they had been an assessable dividend or a dividend respectively, the provision of those benefits will constitute the shareholders obtaining a tax benefit (subsection 45B(9) of the ITAA 1936).

58. In this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 are met, the requisite purpose of enabling the FAL 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) of the ITAA 1936, it would not be concluded that any of the parties to the demerger will enter into or carry out the scheme to obtain a tax benefit in the form of a demerger benefit or a capital benefit.

59. It is plain from the commercial circumstances of the demerger that it is being undertaken to restructure the company's business and that the capital and profit components of the demerger allocation are consistent with those commercial circumstances. It is also apparent that there is nothing in the other relevant circumstances of the demerger, including the company's distribution history or the known circumstances of the shareholders, to suggest that the favourable tax outcome of the demerger for the shareholders is anything more than the natural incident of the business restructure.

Detailed contents list

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

	Paragraph
What this Class Ruling is about	1
Tax law(s)	2
Class of persons	3
Qualifications	4
Date of effect	8
Withdrawal	9
Arrangement	10
The Demerger Scheme	14
The Transfer Scheme	16
Features of the Demerger Scheme	21
Implementation of the Demerger Scheme	27
Ruling	28
CGT event G1	28
Demerger roll-over relief	29
Consequences of roll-over relief	30
Demerger allocation and demerger dividend	33
Explanation	35
CGT event G1	35
Demerger roll-over relief	39
<i>Is FAL the head entity of a demerger group?</i>	41
<i>Has a demerger happened to the demerger group?</i>	44
Consequences of roll-over relief	46
<i>Time of acquisition of PEH shares – CGT discount</i>	49
Demerger allocation and demerger dividend	50
<i>Section 45B – schemes to provide certain benefits</i>	54
Detailed contents list	60

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 97/16;
 TR 2003/8; CR 2001/1;
 CR 2005/75; CR 2005/76

Subject references:

- capital benefit
- capital gains
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary
- return of capital
- roll-over
- schemes to provide certain benefits

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 6D
- 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
- 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)
- ITAA 1936 45B(4)
- ITAA 1936 45B(5)
- ITAA 1936 45B(6)
- ITAA 1936 45B(8)

- ITAA 1936 45B(9)
- ITAA 1936 45B(10)
- ITAA 1936 45BA
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997 104-135
- ITAA 1997 104-135(2)
- ITAA 1997 104-135(3)
- ITAA 1997 109-10
- ITAA 1997 115-25(1)
- ITAA 1997 115-30(1)
- ITAA 1997 Div 125
- ITAA 1997 125-55
- 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(1)
- ITAA 1997 125-70(1)(a)
- ITAA 1997 125-70(1)(b)(i)
- ITAA 1997 125-70(1)(c)(i)
- ITAA 1997 125-70(1)(d)
- ITAA 1997 125-70(1)(e)(i)
- ITAA 1997 125-70(1)(f)
- ITAA 1997 125-70(1)(g)
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- ITAA 1997 125-70(2)(a)
- ITAA 1997 125-70(2)(b)
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- ITAA 1997 125-70(4)
- ITAA 1997 125-70(5)
- ITAA 1997 125-80(1)
- ITAA 1997 125-80(2)
- ITAA 1997 125-80(3)
- ITAA 1997 125-80(5)
- ITAA 1997 125-80(6)
- ITAA 1997 125-85(1)
- ITAA 1997 125-85(2)
- Copyright Act 1968
- TAA 1953 Pt IVA

ATO references

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Appendix A**Glossary of Terms**

<i>Ruling Terminology</i>	<i>Meaning</i>
<i>Certain terms used in this Ruling have the same meaning as corresponding terms in the FAL Scheme Booklet in relation to the demerger and acquisition of FAL by WOW and Metcash</i>	
Capital Reduction	The return of capital on FAL shares to shareholders which under the Demerger Scheme will be applied, together with the Demerger Dividend, as consideration for the transfer of the PEH shares to shareholders
Demerger Dividend	The special dividend which under the Demerger Scheme will be applied, together with the Capital Reduction, as consideration for the transfer of the PEH shares to shareholders
Demerger Implementation Date	The date on which the legal separation of the PEH Group from FAL takes place
Demerger Record Date	Sets the record date for shareholders for the Demerger Scheme.
Demerger Scheme	The scheme of arrangement under which FAL will divest its New Zealand operations
Transfer Scheme	The scheme of arrangement for the transfer of FAL shares to Metcash and for the transfer of PEH shares to Woolworths
Woolworths Action Stores	'Action' branded supermarkets and associated liquor stores in NSW, Queensland and WA as well as development sites in Queensland and WA