


CR 2008/33 - Income tax: capital gains: demerger of Mercury Mobility Ltd by Cellnet Group Ltd

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Class Ruling

Income tax: capital gains: demerger of Mercury Mobility Ltd by Cellnet Group Ltd

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① 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, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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 provisions identified below apply to the defined class of entities, who took 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 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.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Cellnet Group Limited (Cellnet) who:
- (a) participated in the scheme that is the subject of this Ruling;
 - (b) owned ordinary shares in Cellnet and held those shares on capital account at the time of the demerger; and
 - (c) were residents of Australia (as that term is defined in subsection 6(1) of the ITAA 1936) at the time of the demerger.
4. This class of entities is referred to, collectively and individually, as the 'participating Cellnet shareholder(s)' in this Ruling.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.
6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out was carried out in accordance with the scheme described in paragraphs 14 to 35 of this Ruling.
7. If the scheme actually carried out was 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.
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Date of effect

9. This Ruling applies from 1 July 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

10. 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 issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the participating Cellnet shareholders may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

14. The following description of the scheme is based on information provided by Johnston Rorke (the applicant for this Ruling).

Note: where certain information has been provided by the applicant on a commercial-in-confidence basis it will not be disclosed or released under the Freedom of Information legislation.

Background

15. The scheme that is the subject of this Ruling involves the demerger by Cellnet of Mercury Mobility Limited (Mercury).

Cellnet

16. Cellnet is an Australian resident public company listed on the Australian Securities Exchange (ASX).

17. Cellnet is a distributor of mobile phones, audio visual and information technology products, and computers and related products to retail and wholesale customers in Australia and New Zealand.

18. At the time of the demerger, Cellnet had 53,099,324 ordinary shares on issue. It also had 341,869 performance rights on issue.

19. There were no other ownership interests in Cellnet just before the demerger.

20. At the time of the demerger the performance rights represented less than 3% of all ownership interests having regard to either or both of their number and value.

21. One Cellnet shareholder, CVC Limited, owned more than 20% of the ownership interests in Cellnet at the time of the demerger. Cellnet chose under subsection 125-65(5) of the ITAA 1997 that CVC Limited be excluded from the demerger group.

Mercury

22. Mercury is a resident Australian company.

23. Mercury is a mobile phone personalisation, entertainment and technology company which delivers and produces ring tones, created and licensed true tones, video assets, ring back tones, wallpapers and animations, mobile music download services, a range of mobile television services and a user generated platform called 'You Me Now' (collectively referred to as mobile phone service businesses).

24. At the time of the demerger, Mercury had 80,000,000 ordinary shares on issue. There were no other ownership interests in Mercury just before the demerger.

25. Mercury undertook a capital raising by way of an Initial Public Offer after the demerger, raising approximately \$3,000,000.

26. Mercury listed on the ASX for trading on 2 August 2007.

Transactions facilitating the distribution of Mercury shares

27. Prior to distributing the Mercury shares under the demerger, Cellnet and its subsidiaries undertook a number of transactions to facilitate the distribution of the Mercury shares, including the following:

- Cellnet caused Mercury to be incorporated as a wholly owned subsidiary;

- Cellnet (and other subsidiaries of Cellnet) transferred ownership of a number of companies to Mercury. These entities carry on the mobile phone service businesses, and are as follows:
 - Mercury Mobility Pty Limited (which later changed its name to Mercury Mobility (Australia) Pty Ltd);
 - Mercury Mobility Europe Limited (a UK subsidiary);
 - Mercury Mobility Canada Inc (a Canadian subsidiary); and
 - Jatek Pty Limited; and
- the shares in Mercury were split such that it had 80,000,000 ordinary shares on issue just before the distribution of the shares under the demerger.

Distribution of the Mercury shares under the demerger

28. On 7 June 2007 Cellnet undertook a demerger by distributing all of the 80,000,000 ordinary shares it held in Mercury to its shareholders. Owners of Cellnet ordinary shares received 1.50662 Mercury ordinary shares for each Cellnet share they held at the record date (which was 7 June 2007).

29. The demerger was undertaken by way of a distribution of share capital and profits of Cellnet, satisfied by the *in specie* distribution of Mercury ordinary shares. The Cellnet ordinary shareholders received a distribution of share capital of \$5,991,752 in total (or 11.28 cents per ordinary Cellnet share) (the capital reduction amount). Cellnet recorded a distribution of profits of \$18,364,119 in total (or approximately 35 cents per ordinary Cellnet share).

Reasons for the demerger

30. The demerger was undertaken to allow Cellnet and Mercury to separately pursue their individual businesses. The purpose of the demerger was to improve the performance of the respective businesses. Their separation was considered desirable having regard to the fundamental differences in those business and the underlying revenue models, operations, risks, expansion prospects, the management skills required to successfully operate their businesses and the nature of their future growth and expansion.

31. The demerger has allowed a new Board to manage Mercury. The Board considers that it has the different industry experience and skills required to manage and grow the Mercury business successfully. The Board of Cellnet has remained the same and will concentrate on Cellnet's distribution business.

Other matters

32. None of the participating Cellnet shareholders acquired their shares in Cellnet before 20 September 1985.

33. Cellnet confirms that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997, from any of its other accounts, and has therefore not been tainted within the meaning of Division 197 of the ITAA 1997.

34. Just after the demerger, Cellnet advised that at least 50% of the market value of capital gains tax (CGT) assets owned by Mercury or its subsidiaries were used directly or indirectly in one or more businesses carried on by Mercury or any of its subsidiaries.

35. Cellnet has not elected under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 not apply to the demerger dividend paid under the restructure.

Ruling

Capital gains tax consequences

CGT event G1

36. CGT event G1 happened in relation to the Cellnet ordinary shares owned by the participating Cellnet shareholders at the time Cellnet made the payment of the capital reduction amount (section 104-135 of the ITAA 1997).

37. Participating Cellnet shareholders made a capital gain under CGT event G1 if the capital reduction amount (of 11.28 cents per ordinary Cellnet share) exceeded the cost base of the Cellnet share (subsection 104-135(3) of the ITAA 1997).

Disregarding the capital gain under CGT event G1 by choosing demerger roll-over relief

38. A demerger, as described under section 125-70 of the ITAA 1997, happened under the scheme. The capital raising undertaken by Mercury after the demerger does not cause an entity that owned an original ownership interest in the head entity of the demerger group to acquire something else under the restructuring of the demerger group other than its new interest for the purpose of paragraph 125-70(1)(c) of the ITAA 1997.

39. Therefore, participating Cellnet shareholders can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their Cellnet shares.

40. Participating Cellnet shareholders will disregard any capital gain made under CGT event G1 if they choose demerger roll-over relief (subsection 125-55(1) and subsection 125-80(1) of the ITAA 1997).

Other consequences of choosing demerger roll-over relief

41. If a participating Cellnet shareholder chooses demerger roll-over relief, they must also recalculate the cost base and reduced cost base of the Cellnet and Mercury shares.

42. The first element of the cost base (and reduced cost base) of the Cellnet shares and corresponding Mercury shares received under the demerger is worked out by taking the sum of the cost bases of the participating Cellnet shareholders shares (just before the demerger) and then apportioning that sum over their remaining Cellnet shares and corresponding new Mercury shares received under the demerger. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Cellnet shares and Mercury shares, or a reasonable approximation of those market values (subsections 125-80(2) and (3) of the ITAA 1997).

Participating Cellnet shareholders who do not choose demerger roll-over relief

43. For participating Cellnet shareholders who do not choose demerger roll-over relief:

- they are not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their Cellnet shares under the demerger; and
- the first element of the cost base and reduced cost base of the Cellnet shares and the corresponding Mercury shares is calculated in the manner described in paragraph 42 of this Ruling (subsections 125-85(1) and (2) of the ITAA 1997).

Acquisition date of the Mercury shares for the purposes of the CGT discount

44. For the purpose of accessing the CGT discount, the Mercury shares received by the participating Cellnet shareholders are taken to have been acquired on the same date as the corresponding Cellnet shares (item 2 of subsection 115-30(1) of the ITAA 1997). This will be the case whether demerger roll-over relief is chosen or not.

Dividend consequences

Demerger dividend

45. Any dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936).

46. The demerger dividend is neither assessable income nor exempt income of the participating Cellnet shareholders (subsections 44(3) and (4) of the ITAA 1936).

47. As the capital reduction amount will be debited to Cellnet's share capital account it will not be a dividend, as defined in subsection 6(1) of the ITAA 1936 (see the exclusion contained in paragraph (d) of the definition of a dividend in subsection 6(1) of the ITAA 1936).

Application of sections 45B, 45BA and 45C

48. 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 participating Cellnet shareholders under the demerger.

49. 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 participating Cellnet shareholders under the demerger.

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 event G1

50. CGT event G1 happened in relation to the Cellnet ordinary shares owned by the participating Cellnet shareholders at the time that Cellnet made the payment of the capital reduction amount as the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount taken to be a dividend under section 47 of the ITAA 1936 (section 104-135 of the ITAA 1997).

51. A Cellnet shareholder will make a capital gain if the capital reduction amount is more than the cost base of their Cellnet share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

52. A Cellnet shareholder cannot make a capital loss when CGT event G1 happens (note 1 of subsection 104-135(3) of the ITAA 1997).

53. If the Cellnet share to which the payment relates was acquired by a Cellnet shareholder at least 12 months before the payment of the capital reduction amount, a capital gain made from CGT event G1 may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

Demerger roll-over relief

54. Demerger roll-over enables a shareholder to choose to disregard a capital gain made as a result of CGT event G1 happening when a non-assessable payment is made in relation to a share under a demerger.

55. The demerger roll-over provisions in Division 125 of the ITAA 1997 contain a number of conditions for eligibility to choose demerger roll-over relief. The main conditions that are relevant to the scheme to which this Ruling relates are:

- (i) a shareholder owns a share in a company;
- (ii) the company is the head entity of a demerger group;
- (iii) a demerger happens to the demerger group; and
- (iv) under the demerger a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity.

56. Under the scheme to which this Ruling relates the conditions for demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied. Further, the scheme to which this Ruling relates raises no novel issues of tax law interpretation and no further explanation of the application of those tax laws beyond that contained in the Ruling part of this document is necessary.

Section 45B – schemes to provide certain benefits

57. 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.

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 participating Cellnet shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

59. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(a) or (b) of the ITAA 1936 that either sections 45BA or 45C of the ITAA 1936 applies to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Subject references:

- capital benefit
- capital gains
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger rollover
- demerger subsidiary
- return of capital on shares

Legislative references:

- ITAA 1936 6(1)
 - ITAA 1936 44
 - ITAA 1936 44(2)
 - ITAA 1936 44(3)
 - ITAA 1936 44(4)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
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 - ITAA 1936 45B(3)(a)
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 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25(1)
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-65(5)
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 - ITAA 1997 125-70(1)(c)
 - ITAA 1997 125-80(1)
 - ITAA 1997 125-80(2)
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ATO references

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