


CR 2011/104 - Income tax: demerger of BQF unit trust by Pelorus Private Equity Limited

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Class Ruling

Income tax: demerger of BQF unit trust by Pelorus Private Equity Limited

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ⓘ 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 take part in the Scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provision(s) 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 45 of the ITAA 1936;
- section 45A 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;

- Division 125 of the ITAA 1997;
- section 975-300 of the ITAA 1997; and
- subsection 975-300(3) of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the holders of shares in Pelorus Private Equity Limited (Pelorus) who on the Record Date (7 October 2011):

- (a) were listed on the share register of Pelorus;
- (b) held their Pelorus shares on capital account;
- (c) were a 'resident of Australia' as defined in subsection 6(1) of the ITAA 1936; and
- (d) were not subject to the taxation of financial arrangement rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Pelorus shares.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, a person belonging to this class of entities is referred to as a 'Pelorus shareholder'.

Qualifications

4. The Commissioner makes this Ruling based on the precise Scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the Scheme actually carried out is carried out in accordance with the Scheme described in paragraphs 9 to 34 of this Ruling.

6. If the Scheme actually carried out is 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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Barton ACT 2600

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Date of effect

8. This Ruling applies from 1 July 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the Scheme is based on information provided by the applicant.

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

10. The demerger by Pelorus of BQF unit trust (BQF) was approved by Pelorus shareholders at an Extraordinary General Meeting held on 22 December 2010.

Pelorus

11. On 10 January 2011 Pelorus Property Group Limited delisted from the Australian Securities Exchange (ASX) and changed its name to Pelorus Private Equity Group. Pelorus is an unlisted public company that is an Australian resident company and is the head company of a consolidated tax group for the purposes of Part 3-90 of the ITAA 1997.

12. Pelorus is a structured finance, funds management and property services company which just prior to the demerger had three distinct sub-groups:

- property development and fund investments;
- development of the Bakehouse Quarter; and
- passive investments

13. Before the demerger, Pelorus was a vertically integrated property group generating fee income from its structured finance, funds management and property services.

14. Immediately before the demerger, Pelorus had 381,720,594 fully paid ordinary shares on issue.

15. There were no other ownership interests in Pelorus just before the demerger.

BQF

16. Immediately prior to the demerger BQF was a unit trust, wholly owned by Pelorus.

17. BQF is a special purpose trust that controls the development of the Bakehouse Quarter property site, a large scale real estate development.

BQF Pty Ltd

18. BQF Pty Ltd (BQF Sub) is a member of the consolidated group of which Pelorus is the head entity.

19. BQF Sub's only activity has been to hold the BQF units as part of the Pelorus group.

Pre-demerger transactions

20. Prior to the demerger BQF Sub transferred BQF units to Pelorus.

The demerger

21. On 22 December 2010 shareholders voted at an Extraordinary General Meeting to reduce the share capital of Pelorus by making a pro-rata in specie distribution of all of the fully paid ordinary units in BQF to all holders of ordinary shares in Pelorus.

22. Pelorus shareholders will receive one BQF unit and nothing else for every 19 Pelorus shares they hold on the Record Date.

23. After the demerger, Pelorus shareholders will own shares in Pelorus and units in BQF.

Accounting for the demerger

24. Pelorus accounted for the demerger as follows:

DR Share Capital	\$51,428,997
Retained Earnings	\$9,949,668
CR Net Assets	\$61,378,665

Purpose of the demerger

25. Pelorus' purpose in undertaking the demerger was to promote a more efficient structure for the development of the Bakehouse Quarter and their passive investment business. Pelorus believes that the separation of the two businesses will provide greater clarity of identity to both businesses through the creation of a separate development business and a separate passive investment business.

26. From the perspective of Pelorus, the separation of Pelorus and BQF was considered desirable having regard to the differences in the businesses of the two entities. The separation of the development of the Bakehouse Quarter from the passive investment business is expected to create operational efficiencies through increased focus and financial responsibility for each of the businesses. It will allow for the separate capitalisation of each business and drive efficiency as a result of the independent reporting on the performance of each.

Post demerger

27. BQF is registered as a managed investment scheme with Pelorus as the responsible entity of the fund.

28. Pelorus appointed BlackWall Funds Management Limited as the Investment Manager of the fund under an investment management agreement.

29. BQF will be a public trading trust under Division 6C of the ITAA 1936 for the income year in which the demerger happens.

Other matters

30. Pelorus confirmed that its share capital account was not tainted within the meaning of Division 197 at the demerger implementation date.

31. Pelorus did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) do not apply to the demerger dividend.

32. No Pelorus shareholders acquired their shares in Pelorus before 20 September 1985.

33. There was no off market buy-back of shares under this arrangement or circumstances where Pelorus shareholders could obtain roll-over under another provision of the ITAA 1997.

34. Pelorus confirmed that Capital Gains Tax (CGT) assets representing more than 50% of the market value of all the CGT assets of BQF and its demerger subsidiaries would be used directly or indirectly in a business carried on by BQF or its demerger subsidiaries just after the demerger.

Ruling

The demerger of BQF Sub

CGT event G1

35. CGT event G1 happened in relation to each of the Pelorus ordinary shares owned by Pelorus shareholders at the time Pelorus made the payment of the capital reduction amount (satisfied by the *in specie* distribution of BQF units) (section 104-135).

Capital gain

36. Pelorus shareholders will make a capital gain from CGT event G1 happening if the capital reduction amount exceeds the cost base of the Pelorus ordinary share. The capital gain is equal to the amount of the excess. No capital loss can be made from CGT event G1 (subsection 104-135(3)).

Demerger roll-over

37. A demerger, as defined under section 125-70, happened to the Pelorus demerger group under the scheme.

38. A Pelorus shareholder can choose demerger roll-over under subsection 125-55(1) for their Pelorus ordinary shares.

CGT consequences of choosing roll-over

39. A Pelorus shareholder who chooses demerger roll-over will disregard any capital gain made when CGT event G1 happened in relation to each of their Pelorus ordinary shares under the demerger (subsection 125-80(1)).

Other consequences of choosing roll-over

40. If a Pelorus shareholder chooses demerger roll-over, they must also recalculate the cost base and reduced cost base of their Pelorus ordinary shares and calculate the cost base and reduced cost base of their new BQF units.

41. The first element of the cost base and reduced cost base of each Pelorus ordinary share and corresponding BQF unit received under the demerger is worked out as follows:

- total the cost bases of the Pelorus ordinary shares (just before the demerger); and
- apportion that sum over the Pelorus ordinary shares and corresponding new BQF units received under the demerger.

42. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Pelorus ordinary shares and BQF units, or a reasonable approximation of those market values (subsections 125-80(2) and (3)).

Pelorus shareholders who do not choose demerger roll-over

43. A Pelorus shareholder who does not choose demerger roll-over will not disregard any capital gain made when CGT event G1 happened in relation to a Pelorus ordinary share under the demerger.

44. The first element of the cost base and reduced cost base of each Pelorus ordinary share and corresponding BQF unit is calculated as described in paragraphs 40 to 42 of this Ruling (subsections 125-85(1) and (2)).

Acquisition date of the BQF units for the purpose of a discount capital gain

45. For the purpose of determining eligibility to a discount capital gain, a BQF unit received by a Pelorus shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding Pelorus ordinary shares (item 2 of the table in subsection 115-30(1)). This is the case whether or not the shareholder chooses demerger roll-over.

Distribution is not a dividend for income tax purposes

46. The amount of the in specie distribution to Pelorus shareholders of BQF units under the scheme that is debited to Pelorus' share capital account is not a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

Distribution is a demerger dividend

47. Pelorus shareholders received a demerger dividend as defined in subsection 6(1) of the ITAA 1936 consisting of a pro rata share of the excess of the money value of the *in specie* distribution of BQF units over the amount debited to the share capital account of Pelorus (see Taxation Ruling TR 2003/8).

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

Application of sections 45, 45A, 45B, 45BA and 45C

49. Section 45 and section 45A of the ITAA 1936 will not apply to the whole or any part of the *in specie* distribution provided to Pelorus shareholders under the demerger.

50. 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 Pelorus shareholders under the demerger.

51. 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 Pelorus shareholders under the demerger.

Commissioner of Taxation

7 December 2011

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.*

52. The tax consequences and relevant legislative provisions that arise concerning the scheme that is the subject of this Ruling are outlined in the Ruling part of this document.

The demerger of BQF units

53. The capital gains tax consequences of the demerger of BQF units are described in paragraphs 35 to 45 of this Ruling.

54. The demerger roll-over provisions in Division 125 contain a number of conditions for eligibility to choose roll-over. The main conditions that are relevant to the scheme are:

- (a) person owns a share in a company, or a unit or other interest in a trust (the original interest);
- (b) the company or trust is the head entity of a demerger group;
- (c) a demerger happens to the demerger group; and
- (d) under the demerger, a CGT event happens to the original interest and the person acquires a new or replacement interest in the demerged entity and nothing else.

55. Under the scheme, the conditions for choosing demerger roll-over under Division 125 were satisfied in respect of the demerger of BQF units. In respect of the condition in paragraph 125-70(1)(e) that if the head entity of the demerger group is a company then the new interests are ownership interests in a company; section 125-230 provides that Division 125 applies to a trust that is a public trading trust (such as BQF) for the income year in which the demerger happened as if the trust were a company and the ownership interests in it were interests in a company. As a consequence, the demerger concessions outlined in Division 125, and in subsections 44(3) and (4) of the ITAA 1936, are available to the Pelorus shareholders in respect of the demerger of BQF units.

Distribution is not a dividend for income tax purposes

56. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends, as defined in subsection 6(1) of the ITAA 1936, paid to the shareholders out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident).

57. The term 'dividend' in subsection 6(1) of the ITAA 1936 includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 excludes a distribution from the meaning of 'dividend' if the amount of a distribution is debited against an amount standing to the credit of the company's share capital account.

58. The term 'share capital account' is defined in section 975-300 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

59. Subsection 975-300(3) states that an account is not a share capital account if it is tainted.

60. The *in specie* distribution to Pelorus shareholders of BQF units will be recorded as a debit to Pelorus' share capital account. As the share capital account of Pelorus is not tainted within the meaning of Division 197, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies. Accordingly the amount of the *in specie* distribution to Pelorus shareholders of BQF units that is debited to Pelorus' share capital account is not a 'dividend' as defined in subsection 6(1) of the ITAA 1936. Therefore, it will not be included in the assessable income of Pelorus shareholders under subsection 44(1) of the ITAA 1936.

Distribution is a demerger dividend

61. Pelorus shareholders did receive a dividend pursuant to the demerger to the extent that the market value of the BQF units distributed under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

62. This dividend is not assessable income or exempt income (subsections 44(3) and 44(4) of the ITAA 1936) if:

- the dividend is a 'demerger dividend' (as defined in subsection 6(1) of the ITAA 1936);
- Pelorus (as the head entity of the demerger group) does not elect that subsections 44(3) and 44(4) of the ITAA 1936 will not apply to the demerger dividend (subsection 44(2) of the ITAA 1936); and
- subsection 44(5) of the ITAA 1936 is satisfied.

63. As each of the conditions in paragraph 63 of this Ruling are satisfied, the demerger dividend received by Pelorus shareholders will not be assessable income or exempt income (subsection 44(4) of the ITAA 1936).

Application of sections 45, 45A, 45B, 45BA and 45C**Section 45**

64. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

65. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to the whole or any part of the *in specie* distribution received by Pelorus shareholders.

Section 45A

66. Section 45A of the ITAA 1936 is an anti-avoidance provision that applies where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of capital, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

67. Where the Commissioner makes a written determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole or part of the capital benefits, the capital benefits will be treated as unfranked dividends paid out of the company's profits.

68. Based on the information provided and having regard to the circumstances of the scheme, section 45A of the ITAA 1936 will not apply to the whole or any part of the *in specie* distribution provided to Pelorus shareholders and the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies.

Section 45B

69. Section 45B of the ITAA 1936 is an anti-avoidance provision which, if applicable, allows the Commissioner to make a determination that all or part of a return of capital to be received by shareholders is to be treated as an unfranked dividend.

70. The purpose of section 45B of the ITAA 1936 is to ensure that the relevant amounts distributed to shareholders are treated as dividends for tax purposes if certain payments, allocations and distributions are made in substitution for dividends. Specifically, the provision applies where:

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);

- (b) 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
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so 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).

71. The arrangement involving the *in specie* distribution to Pelorus shareholders of BQF units constitutes a scheme for the purposes of section 45B of the ITAA 1936.

72. The phrase 'provided with a demerger benefit' is defined in subsection 45B(4) of the ITAA 1936 and includes a company providing a person with ownership interests in that or another company. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936 and includes the provision of ownership interests in a company to a person. The *in specie* distribution of BQF units means that Pelorus shareholders will be taken to have been provided with a demerger benefit, and provided with a capital benefit.

73. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the relevant circumstances (as outlined in subsection 45B(8) of the ITAA 1936) of the scheme to determine whether it could be concluded that entities that entered into or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose) of enabling the relevant taxpayer (Pelorus shareholders) to obtain a tax benefit. On the basis of the information surrounding the *in specie* distribution of BQF units as described in the Class Ruling application and further information, the Commissioner has formed the view that the demerger benefits and capital benefits provided to the Pelorus shareholders have not been made for a more than incidental purpose of obtaining a tax benefit.

74. Accordingly, 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 Pelorus shareholders under the demerger of BQF units;
- 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 Pelorus shareholders under the demerger of BQF units.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- capital benefit
- capital gains
- capital proceeds
- CGT event G1-G3 – shares
- cost base adjustments
- demerger

Legislative references:

- | | |
|---------------------|--------------------------|
| - ITAA 1936 | - ITAA 1936 45B(2)(a) |
| - ITAA 1936 Div 6C | - ITAA 1936 45B(2)(b) |
| - ITAA 1936 6(1) | - ITAA 1936 45B(2)(c) |
| - ITAA 1936 6(1)(d) | - ITAA 1936 45B(3)(a) |
| - ITAA 1936 44(1) | - ITAA 1936 45B(3)(b) |
| - ITAA 1936 44(2) | - ITAA 1936 45B(4) |
| - ITAA 1936 44(3) | - ITAA 1936 45B(5) |
| - ITAA 1936 44(4) | - ITAA 1936 45B(8) |
| - ITAA 1936 44(5) | - ITAA 1936 45BA |
| - ITAA 1936 45 | - ITAA 1936 45C |
| - ITAA 1936 45A | - ITAA 1997 104-135 |
| - ITAA 1936 45A(2) | - ITAA 1997 104-135(3) |
| - ITAA 1936 45B | - ITAA 1997 115-30(1) |
| | - ITAA 1997 Div 125 |
| | - ITAA 1997 125-55(1) |
| | - ITAA 1997 125-70 |
| | - ITAA 1997 125-70(1)(e) |
| | - ITAA 1997 125-80(1) |
| | - ITAA 1997 125-80(2) |
| | - ITAA 1997 125-80(3) |
| | - ITAA 1997 125-85(1) |
| | - ITAA 1997 125-85(2) |
| | - ITAA 1997 125-230 |
| | - ITAA 1997 Div 197 |
| | - ITAA 1997 975-300 |
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ATO references

NO: 1-2SMRG62

ISSN: 1445-2014

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Income Tax ~~ Capital Gains Tax ~~ demerger relief