


CR 2011/83 - Income tax: demerger of iiNet Limited by Amcom Telecommunications Limited

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Class Ruling

Income tax: demerger of iiNet Limited by Amcom Telecommunications 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 provisions

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;
- Division 125 of the ITAA 1997; and
- Division 855 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 are the holders of ordinary shares (including unlisted converting shares and unlisted employee shares) in Amcom Telecommunications Limited (Amcom) who:

- (a) were recorded on the share register of Amcom as at 17 August 2011 (the Record Date for the demerger of the shares in iiNet Limited (iiNet));
- (b) held their Amcom shares on capital account on the Record Date; and
- (c) were not subject to the taxation of financial arrangement rules in Division 230 in relation to gains and losses on their Amcom shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

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

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 is carried out in accordance with the scheme described in paragraphs 10 to 38 of this Ruling.

7. 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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Date of effect

9. 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

10. The following description of the scheme is based on information provided by the applicant.

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

Background

11. The scheme that is the subject of this Ruling involves the demerger by Amcom of iiNet.

Relevant entities

Amcom

12. Amcom is an Australian resident company which was established in 1988 and has been listed on the Australian Securities Exchange (ASX) since 1994.

13. Amcom was originally incorporated as International Mineral Resources NL and, up until 1999, was principally involved in activities associated with mining exploration and gold production. However, after fluctuating performances and a deteriorating gold price, the company decided to change the direction of its principal business activities to its current activities as a telecommunications investment company. This change occurred during the year ended 30 June 1999 and the company's gold mining assets were sold during the year ended 30 June 2000.

14. As at 1 March 2011, Amcom had the following ownership interests on issue:

- 716,812,103 ordinary shares listed on the ASX, which included 4,000,000 restricted listed shares;
- 4,114,286 unlisted converting shares;
- 92,166 unlisted fully paid employee ordinary shares; and
- 7,990,000 performance rights issued as part of the executive long-term incentive plan.

15. The unlisted converting shares are a class of ordinary shares in the share capital of Amcom. They are, in all material respects, identical to the listed ordinary shares of Amcom, except that the holders of these shares have a potential right to receive additional bonus ordinary shares in respect of the sale of IP Systems Pty Ltd (IPS).

16. The converting shares were issued to the vendors of IPS as partial consideration for Amcom's acquisition of IPS in 2010. The entitlement to additional shares is contingent on, and calculated by reference to, the performance of IPS subject to a minimum and maximum value as set out in a formula under the terms of issue of the converting shares.

17. The performance rights represent less than 3% of ownership rights in Amcom having regard to the number and value. These interests satisfy the requirements of an employee share scheme for the purposes of Division 83A and are not fully paid ordinary shares.

18. As at 28 February 2011, approximately 98% of the issued ordinary shares in Amcom were held by Australian resident shareholders. The shareholders of Amcom are a mix of individuals, companies, superannuation funds and institutional investors.

19. Prior to the demerger, all of Amcom's performance rights and unlisted employee shares are held by Australian residents.

20. There were no other ownership interests in Amcom just before the demerger.

iiNet

21. iiNet is an Australian resident company listed on the ASX.

22. As at 30 June 2010, iiNet had approximately 151,885,598 fully paid ordinary shares and 764,000 options on issue.

23. There were no other ownership interests in iiNet just before the demerger.

Amcom's investment in iiNet

24. In May 2006, Amcom acquired 21,800,000 ordinary shares in iiNet (an interest of approximately 19.97% of the total ordinary shares on issue in this entity at that time). The original purpose of this shareholding was to receive a combination of capital growth and income.

25. The strategy to acquire an interest in iiNet was originally initiated by a former major shareholder of Amcom who also provided \$23.4 million of capital to Amcom to acquire the interest in iiNet. This major shareholder ceased to be a shareholder of Amcom in December 2008.

26. Between June 2006 and August 2010, Amcom acquired further shares in iiNet on-market and via share placements. Amcom also sold some of its shares in iiNet during this period. As at 31 December 2010, Amcom held 35,547,267 shares in iiNet (an interest of approximately 23.40% of the total ordinary shares on issue in iiNet at that time).

Pre-demerger transactions

27. On 17 June 2011 Amcom sold 4,500,000 of its shares in iiNet on market. The purpose of this share sale was to raise working capital for use in Amcom's business.

28. Following this sale, Amcom held at the time of the demerger 31,047,267 ordinary shares in iiNet (representing approximately 20.4% of the total ownership interests in this entity).

The demerger of iiNet

29. At an extraordinary general meeting on 9 August 2011, Amcom shareholders passed an ordinary resolution approving a capital reduction.

30. On 18 August 2011 (the Distribution date), the capital reduction was satisfied by an *in specie* distribution of 100% of the iiNet shares held by Amcom. Amcom shareholder's received one iiNet share for every 23.2 Amcom shares that they owned at the Record Date of 17 August 2011. Under the demerger, Amcom shareholders received no other form of consideration in addition to the *in specie* distribution of iiNet shares.

31. The iiNet shares were acquired by the Amcom shareholders by applying the following amounts distributed to them by Amcom to the acquisition of the iiNet shares:

- the capital reduction amount (being a return of share capital) of approximately \$0.035 for each Amcom share; and
- the dividend amount (being a dividend paid on each Amcom share) of approximately \$0.063 for each Amcom share.

32. After the demerger, Amcom shareholders held direct ownership interests in both Amcom and iiNet.

Accounting for the demerger transaction

33. Amcom accounted for the distributions that effected the demerger by debiting:

- (a) its share capital account by \$25,493,000 (the total capital reduction); and
- (b) its retained earnings account by \$45,295,000 (the total dividend).

Reasons for the demerger

34. Amcom has provided the following commercial reasons for the demerger of iiNet:

- the investment in iiNet does not provide any operational efficiencies or influences that translate into earnings to Amcom, other than ordinary shareholder earnings;
- the stock market does not fully reflect the value of the investment in iiNet in its assessment of Amcom's value;
- Amcom's primary focus is corporate, government and wholesale markets, which differs from iiNet's focus on the mass consumer market. In this respect, the businesses are different and target different customers;
- Amcom's and iiNet's risk profile and risk parameters are substantially different. They are subject to different regulatory environments due to operating in different industry segments;
- Amcom and iiNet will be able to independently focus on maximising their return on capital by addressing their individual business needs and pursuit of different growth opportunities; and

- Amcom will be able to more easily undertake capital raisings specific to its business.

Other matters

35. Amcom has confirmed that its share capital account was not tainted within the meaning of Division 197 at the time of the demerger.

36. Just after the demerger, at least 50% of the market value of all the CGT assets owned by iiNet were used in carrying on a business.

37. Amcom has not made an election pursuant to subsection 44(2) of the ITAA 1936 that subsections 44(3) and 44(4) of the ITAA 1936 will not apply to any dividend paid under the demerger.

38. Certain foreign Amcom shareholders who were resident in a jurisdiction that restricts or prohibits the distribution of iiNet shares were not issued with iiNet shares. Instead, the iiNet shares to which they were entitled under the demerger were sold by Amcom on behalf of those shareholders as soon as practicable after the Record Date.

Ruling**CGT Consequences*****CGT event G1***

39. CGT event G1 happened in relation to each Amcom share owned by an Amcom shareholder at the time Amcom made the payment of the capital reduction amount under the demerger (section 104-135).

Capital gain

40. An Amcom shareholder made a capital gain from CGT event G1 that happened if the capital reduction amount received for each Amcom share exceeded the cost base of that 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

41. Amcom and iiNet are part of a demerger group under subsection 125-65(1).

42. A demerger, as described in section 125-70, happened to this demerger group under the scheme.

43. An Amcom shareholder can choose demerger roll-over relief under subsection 125-55(1) for their Amcom shares.

CGT consequences of choosing roll-over

44. An Amcom shareholder who chooses demerger roll-over relief disregards any capital gain made when CGT event G1 happened to their Amcom shares under the demerger (subsection 125-80(1)).

Other CGT consequences of choosing roll-over

45. An Amcom shareholder who chooses demerger roll-over must also recalculate the cost base and reduced cost base of their Amcom shares and calculate the cost base and reduced cost base of their new iiNet shares.

46. The first element of the cost base and reduced cost base of each Amcom share and new iiNet share received under the demerger is worked out (under subsection 125-80(2)) as follows:

- take the sum of the cost bases of the Amcom shares (worked out just before the demerger); and
- apportion that sum over the Amcom shares and new iiNet shares received under the demerger.

47. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Amcom shares and iiNet shares, or an anticipated reasonable approximation of those market values (subsections 125-80(2) and (3)).

48. The Commissioner accepts that a reasonable apportionment of the summed cost base is to:

- attribute 73% of the summed cost base to the Amcom shares; and
- attribute 27% of the summed cost base to the iiNet shares.

Amcom shareholders who do not choose demerger roll-over

49. An Amcom shareholder who does not choose demerger roll-over cannot disregard any capital gain made when CGT event G1 happened to their Amcom share under the demerger.

50. The first element of the cost base and reduced cost base of each Amcom share and new iiNet share is calculated in the same manner as if they had chosen demerger roll-over as described in paragraphs 46 to 48 of this Ruling (subsections 125-85(1) and (2)).

Acquisition date of the iiNet shares for the purposes of a discount capital gain

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

Foreign resident Amcom shareholders

52. Amcom shareholders disregard a capital gain from CGT event G1 that happened to each of their Amcom shares if:

- they were a foreign resident just before the CGT event happened; and
- their Amcom shares were not taxable Australian property (section 855-10).

53. Amcom shareholders who are foreign residents and their Amcom shares were taxable Australian property cannot disregard (under section 855-10) any capital gain made from CGT event G1 that happened to their shares under the demerger.

54. Amcom shareholders who are foreign residents cannot choose demerger roll-over under subsection 125-55(1) for their Amcom shares if the iiNet shares they acquired under the demerger are not taxable Australian property just after they acquired them (subsection 125-55(2)).

55. The first element of the cost base and reduced cost base of each Amcom share and new iiNet share is calculated in the same manner as if they had chosen demerger roll-over (see paragraphs 46 to 48 of this Ruling (subsections 125-85(1) and 125-85(2))).

Dividend consequences

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

57. The demerger dividend is neither assessable income nor exempt income of the Amcom shareholder (subsections 44(3) and (4) of the ITAA 1936).

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

Application of sections 45B, 45BA and 45C of the ITAA 1936

59. 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 Amcom shareholders under the demerger.

60. 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 Amcom shareholders under the demerger.

Commissioner of Taxation

21 September 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.*

61. 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.

62. The significant tax consequence of the scheme is that the distribution of the iiNet shares happened under a demerger for the purposes of the ITAA 1997 and the ITAA 1936.

Demerger roll-over

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

- (a) a shareholder owns a share in a company (the original interest);
- (b) the company 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 a new or replacement interest is acquired in the demerged entity.

64. Under the scheme, the conditions for choosing demerger roll-over under Division 125 were satisfied in respect of the demerger of iiNet. As a consequence, demerger relief in Division 125 is available to the Amcom shareholders in respect of the demerger of iiNet.

Demerger dividend

65. Subsection 44(1) of the ITAA 1936 operates to include in a shareholder's assessable income any dividend, within the meaning of that term in subsection 6(1) of the ITAA 1936, paid to a shareholder out of company profits.

66. Paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 provides that a dividend excludes amounts debited against an amount standing to the credit of the share capital account of the company.

67. In the circumstances of this demerger, Amcom debited a capital reduction amount to its 'share capital account' as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300 of the ITAA 1997. This amount is therefore not a dividend for the purposes of subsection 6(1) of the ITAA 1936 and is not assessable as a dividend under subsection 44(1) of the ITAA 1936.

68. It is also noted that the exclusion in paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 is limited by subsection 6(4) of the ITAA 1936 which applies in circumstances where, under an arrangement:

- (a) a company raises share capital, receiving either money or property from a person or group of persons, crediting the amount received to its share capital account; and
- (b) distributes money or property to another person or group of persons, with the amount distributed being debited to its share capital account.

69. In the present case, no arrangement existed under which Amcom raised share capital from certain shareholders and then distributed the share capital to other shareholders. Accordingly, subsection 6(4) of the ITAA 1936 has no application in respect of the demerger.

70. Amcom shareholders did however receive a dividend to the extent that the market value of the iiNet shares distributed under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

71. This dividend is neither an assessable income nor an exempt income amount (subsections 44(3) and (4) of the ITAA 1936) if:

- the dividend is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936);
- the head entity did not elect 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.

72. In the present circumstances, each of the conditions in paragraph 71 of this Ruling was satisfied. Therefore, the dividend received by Amcom shareholders under the demerger is neither assessable income nor exempt income by operation of subsections 44(3) and (4) of the ITAA 1936.

Application of sections 45B, 45BA and 45C of the ITAA 1936

73. 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.

74. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, subsection 45B(3) of the ITAA 1936 empowers the Commissioner to make a determination that either section 45BA of the ITAA 1936 applies in relation to a demerger benefit or section 45C of the ITAA 1936 applies in relation to a capital benefit.

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

76. 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

77. The following is a detailed contents list for this Ruling:

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- Previous draft:*
- ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
- Not previously issued as a draft
- ITAA 1936 45B(3)
- Related Rulings/Determinations:*
- ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
- TR 2003/8; TR 2006/10
- ITAA 1936 45BA
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- Subject references:*
- capital benefit
 - capital gains
 - CGT capital proceeds
 - CGT events
 - cost base adjustments
 - demerger
 - demerger allocation
 - demerger benefit
 - demerger dividend
 - demerger group
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ATO references

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