


CR 2012/106 - Income tax: demerger of Auzex Exploration Limited by Auzex Resources Limited

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Class Ruling

Income tax: demerger of Auzex Exploration Limited by Auzex Resources 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 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);
- section 109-5 of the 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 consists of the shareholders of Auzex Resources Limited (Auzex) who:

- (a) were listed on the share register of Auzex as at the Record Date (30 December 2011);
- (b) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Record Date;
- (c) held their Auzex shares on capital account on the Record Date; and
- (d) are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on Auzex 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.)

In this Ruling, a person belonging to this class of entities is referred to as an 'Auzex 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 33 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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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: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Background

10. On 29 August 2011, Auzex announced to the Australian Securities Exchange (ASX) its intention to merge with GGG Resources plc so that their respective 50% interests in the Bullabulling Gold Project would be combined under the common ownership of a new company, Bullabulling Gold Limited.

11. A condition of this merger was that Auzex was required to divest itself of its non-Bullabulling assets. These non-Bullabulling assets were consolidated into a new entity, Auzex Exploration Limited (AEL).

12. On 16 December 2011 Auzex shareholders approved the demerger of AEL by Auzex. The demerger was implemented on 6 January 2012 (the Implementation Date).

Relevant entities

Auzex Resources Limited

13. Auzex was a minerals exploration company. It was incorporated in Australia in September 2003 as a proprietary company and converted to a public company limited by shares in July 2005. Auzex listed on the ASX in October 2005.

14. Auzex's core business was the development of its interest in the Bullabulling Gold Project located approximately 60km south west of Kalgoorlie in Western Australia.

15. Prior to the incorporation of AEL and the demerger, Auzex also held an advanced exploration portfolio of six exploration projects (the non-Bullabulling Projects) and undertook exploration and development activities in relation to these projects.

16. As at 30 December 2011 (immediately prior to the demerger, Auzex had on issue:

- 130,206,265 listed ordinary shares;
- 10,262,300 listed options; and
- 2,369,904 unlisted options.

17. The unlisted options were issued pursuant to the Auzex employee share ownership plan and represented less than 3% of the ownership interests in Auzex (taking into account both their number and value). In addition, the outstanding options issued (both listed and unlisted) represented less than 10% of the ownership interests in Auzex (taking into account both their number and value).

18. Where Auzex option holders had not exercised their options before the Implementation Date, the exercise price of each option was reduced to take into account the capital reduction resulting from the demerger.

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

Auzex Exploration Limited

20. AEL was incorporated in Australia in October 2011 as a public company limited by shares.

21. AEL's business focuses on the exploration, appraisal and development of Auzex's former non-Bullabulling Projects.

22. As at 11 November 2011, AEL had one share on issue which was held by Auzex.

Pre-demerger transactions

23. Immediately prior to the demerger, Auzex undertook the following transfers to AEL to facilitate the demerger:

- its non-Bullabulling Projects and associated assets;
- a parcel of shares in GGG;
- all the issued shares in Auzex Resources (NZ) Pty Ltd; and
- an initial cash contribution.

24. In accordance with the scheme of arrangement, on the Implementation Date, and prior to implementing the scheme, AEL issued AEL shares to Auzex. The number of shares issued was calculated by reference to the number of Auzex shares on issue at the Record Date.

The demerger

25. The demerger of AEL by Auzex was effected by:
- a reduction in share capital by Auzex;
 - the application of the reduction in share capital proceeds (the capital reduction amount) of the Auzex shareholders as consideration for the transfer to the shareholders of the AEL shares in accordance with the demerger scheme of arrangement; and
 - the transfer to each Auzex shareholder of one AEL share for each six Auzex shares held at the Record Date.

Ineligible foreign shareholders

26. AEL shares were not issued to certain shareholders of Auzex whose address was in a place outside Australia (ineligible foreign shareholders). The AEL shares to which the ineligible foreign shareholders would have been entitled were instead sold through a share sale facility with the net proceeds paid to the relevant Auzex shareholder.

Accounting for the demerger

27. Auzex accounted for the demerger by debiting its share capital account by the capital reduction amount, \$9,343,440, which reflected the amount of share capital of Auzex that was applied to the AEL investment.

Reasons for the demerger

28. Auzex's purpose in undertaking the demerger was to create long-term value for Auzex shareholders.

29. The separation of Auzex's non-Bullabulling Projects from its interest in the Bullabulling Gold Project created an exploration business in AEL with independent strategic, operational and investment objectives that would be capable of responding quickly and effectively to future opportunities for strategic growth.

30. Furthermore, the demerger has allowed the subsequent merger between Auzex and GGG to proceed, which resulted in the ownership of the Bullabulling Gold Project to be unified under the single ownership of a new Australian company (Bullabulling Gold Limited).

Other matters

31. Just after the demerger of AEL, at least 50% of the market value of capital gains tax (CGT) assets owned by AEL and its subsidiaries were used in carrying on a business by those entities.

32. Auzex confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997 at the demerger Implementation Date.

33. Auzex has never paid a dividend to its shareholders.

Ruling

Capital gains tax (CGT)

CGT event G1

34. CGT event G1 happened in relation to each Auzex share owned by an Auzex shareholder at the time Auzex made the payment of the capital reduction amount under the demerger (section 104-135 of the ITAA 1997).

35. An Auzex shareholder made a capital gain when CGT event G1 happened if the capital reduction amount received for each Auzex 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 when CGT event G1 happens (subsection 104-135(3) of the ITAA 1997).

Demerger roll-over

36. Auzex and its subsidiary AEL were part of a demerger group under subsection 125-65(1) of the ITAA 1997.

37. A demerger, as described under section 125-70 of the ITAA 1997, happened to the Auzex demerger group under the scheme.

38. An Auzex shareholder can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997.

CGT consequences of choosing roll-over

39. An Auzex shareholder who chooses demerger roll-over relief can disregard any capital gain made when CGT event G1 happened to their Auzex shares under the demerger (subsection 125-80(1) of the ITAA 1997).

Other CGT consequences of choosing roll-over

40. If an Auzex shareholder chooses roll-over relief, they must also recalculate the cost base and reduced cost base of their Auzex shares and calculate the cost base and reduced cost base of their AEL shares.

41. The first element of the cost base and reduced cost base of each Auzex share and corresponding AEL share received under the demerger is worked out as follows:

- sum the cost base of each Auzex share (just before the demerger); and
- apportion that sum over the Auzex shares and corresponding new AEL shares received under the demerger on a reasonable basis, having regard to the market values (just after the demerger) of the Auzex and AEL shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

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

- attribute 72.2% of the summed cost base to the Auzex shares; and
- attribute 27.8% of the summed cost base to the AEL shares.

Auzex shareholders who do not choose roll-over

43. An Auzex shareholder who does not choose demerger roll-over relief:

- is not entitled to disregard any capital gain made when CGT event G1 happened to their Auzex shares under the demerger; and
- the first element of the cost base and reduced cost base of each Auzex share and the corresponding AEL share is calculated in the same manner as if they had chosen demerger roll-over relief (see paragraphs 41 and 42 of this Ruling (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of AEL shares

44. For the purpose of determining eligibility for a discount capital gain, the AEL shares received by an Auzex shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding Auzex shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This is the case whether demerger roll-over relief is chosen or not.

45. For all other CGT purposes, an Auzex shareholder acquired their AEL shares on the date that the AEL shares were transferred to them by Auzex, being the Implementation Date (subsection 109-5(2) of the ITAA 1997).

Dividend

46. As the capital reduction amount was debited to Auzex's share capital account it is not a dividend, as defined in subsection 6(1) of the ITAA 1936.

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

47. Sections 45 and 45A of the ITAA 1936 will not apply to the whole or any part of any demerger benefit provided to an Auzex shareholder under the demerger.

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 an Auzex shareholder 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 an Auzex shareholder under the demerger.

Commissioner of Taxation

28 November 2012

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 consequences

50. A significant tax consequence of the scheme is the availability of demerger roll-over under Division 125 of the ITAA 1997. Broadly, an Auzex shareholder can choose roll-over relief to disregard a capital gain made under the demerger. There are special rules for calculating the cost base and reduced cost base of the Auzex and AEL shares for an Auzex shareholder whether or not they choose roll-over relief.

Conditions for demerger roll-over relief

51. Subsection 125-55(1) of the ITAA 1997 provides that roll-over relief may be chosen if, at the time of the scheme:

- a shareholder owns a share in a company – this requirement is satisfied as participating shareholders owned shares in Auzex;
- the company is the head entity of a demerger group – this requirement is satisfied as Auzex is the head company of a demerger group;
- a demerger happens to the demerger group – this requirement is satisfied as a demerger happened to the Auzex demerger group; and
- under the demerger, a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity and nothing else – this requirement is satisfied because CGT event G1 happened to the Auzex shares (see paragraphs 34-35 of this Ruling) and Auzex shareholders received AEL shares only under the demerger.

52. Under the scheme, the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 were satisfied. As a consequence, demerger relief in Division 125 of the ITAA 1997 is available to an Auzex shareholder in respect of the demerger of AEL.

Dividend

53. Subsection 44(1) of the ITAA 1936 includes 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.

54. 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.

55. 'Share capital account' is defined in section 975-300 of the ITAA 1997 as an account that 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.

56. However, subsection 975-300(3) of the ITAA 1997 provides that an account is not a share capital account if it is tainted. A share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the share capital account where the account is not already tainted.

57. In the circumstances of this demerger, Auzex debited a capital reduction amount to its 'share capital account' as that term is defined in section 975-300 of the ITAA 1997. As that account was not tainted 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.

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

Section 45

58. 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%.

59. 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 any demerger benefit received by an Auzex shareholder.

Section 45A

60. Section 45A of the ITAA 1936 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.

61. 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 profile.

62. 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 any demerger benefit provided to an Auzex shareholder and the Commissioner will not make a determination under subsection 45A(2) that section 45C of the ITAA 1936 applies.

Section 45B

63. 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.

64. 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 an Auzex shareholder to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

65. Accordingly, the Commissioner will not make a determination under paragraphs 45B(3)(a) or 45B(3)(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

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital benefit
- capital gains
- CGT capital proceeds
- CGT events G1-G3 – shares
- cost base adjustments
- demerger
- demerger roll-over
- return of capital on shares

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)

- ITAA 1936 45B(3)
 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1997
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 109-5(2)
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-65(1)
 - ITAA 1997 125-70
 - ITAA 1997 125-80(1)
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 - ITAA 1997 125-80(3)
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 - ITAA 1997 Div 197
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ATO references

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