CR 2013/37 - Income tax: demerger of Duketon Mining Limited by South Boulder Mines Ltd

Australian Government
Australian Taxation Office

Class Ruling

Income tax: demerger of Duketon Mining Limited by South Boulder Mines Ltd

Contents Para

This publication provides you with the following level of protection:

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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 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 South Boulder Mines Ltd (STB) who:

(a) were listed on the share register of STB as at the Record Date (12 April 2013);

(b) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Record Date;

(c) held their STB 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 STB 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 'STB 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 30 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.

Date of effect

8. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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 the 18 October 2012, STB announced to the Australian Securities Exchange (ASX) that it intended to undertake a demerger of its non-potash assets, including listed investments as well as cash of $1 million, to be held in Duketon Mining Limited (Duketon). Following shareholder approval, the demerger was implemented on 15 April 2013 (the Implementation Date) by way of an *in specie* distribution of 100% of the shares in Duketon to STB shareholders.

Relevant entities

South Boulder Mines Ltd

11. STB is an Australian mining exploration and development company with key projects in Eritrea and Western Australia.

12. STB was incorporated in 2001 and listed on the ASX in 2003. STB is also listed in several foreign jurisdictions.

13. STB's primary focus is on developing a potash deposit located in Eritrea, known as the Colluli Potash Project. STB is currently undertaking a definitive feasibility study of the Colluli Potash Project.

14. Prior to the demerger, the non-potash assets held by STB included:

- the Duketon Project in Western Australia, a suite of gold, nickel sulphide and base metal projects; and
- interests in various other gold, nickel, phosphate and metals exploration licences and exploration licence applications.

15. Immediately prior to the demerger, STB had on issue:

- 127,952,826 shares;
- 18,050,000 unlisted options over ordinary shares held by employees and contractors of STB under STB's option plans; and
- 1,397,000 performance rights held by directors, employees and consultants which gave the holder the right to acquire shares in STB under the terms and conditions of STB's performance rights plan.

16. The unlisted options and performance rights were valued at an amount that represented less than 10% of the total ownership interests in STB.

17. The exercise price of the options and number of shares to which the performance rights related were appropriately adjusted taking into account the value of the demerger distribution.

18. There were no other ownership interests in STB just before the demerger.

Duketon Mining Limited

19. Duketon was incorporated in Australia in June 2012.

20. Duketon's primary focus will be the continued exploration and development of the Duketon Project and the other various gold, nickel and phosphate assets, currently being undertaken by STB.

21. Immediately prior to the demerger, Duketon had 31,683,208 ordinary shares on issue, which were wholly owned by STB.

Pre-demerger transactions

22. Prior to the demerger, STB and Duketon entered into a sale and purchase agreement to effect the transfer of the following to Duketon by STB:

- STB's direct interests in its non-potash assets;
- a share portfolio of listed share investments in non-related entities; and
- cash of $1 million.

23. In consideration for these transfers, Duketon issued 31,683,206 ordinary shares to STB.

The demerger

24. The demerger of Duketon by STB was effected by:

- a reduction in share capital by STB by an amount equivalent to the market value of the Duketon shares;

- the application of the reduction in share capital proceeds (the capital reduction amount) of the STB shareholders as consideration for the transfer to the shareholders of the Duketon shares in accordance with the demerger scheme of arrangement; and
- the transfer to each STB shareholder of one Duketon share for each four STB shares held at the Record Date.

25. Following the demerger, Duketon will be a self sustaining operation with sufficient working capital to enable it to meet its operating requirements. It is anticipated that Duketon will then list on the ASX and undertake a capital raising.

Overseas shareholders

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

Accounting for the demerger

27. STB accounted for the demerger by debiting its share capital account by the capital reduction amount, which reflected the amount of share capital of STB that was applied to the Duketon investment.

Reasons for the demerger

28. STB's purpose in undertaking the demerger was to create long-term value for STB shareholders. Specifically, the demerger:

- allowed a clear separation between two distinct businesses – the Colluli Potash Project and the Duketon gold, nickel and phosphate assets;
- better placed each business to separately access capital markets for funding, as well as having their own strategic and operational management; and
- ensured that the value of the demerged assets will be appropriately recognised and enable current and future shareholders to selectively invest in the Colluli Potash Project or the Duketon gold, nickel and phosphate assets.

Other matters

29. STB confirms that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997 at the demerger Implementation Date.

30. STB has never paid a dividend to its shareholders.

Ruling

Capital gains tax (CGT)

CGT event G1

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

32. An STB shareholder made a capital gain when CGT event G1 happened if the capital reduction amount received for each STB 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

33. STB and its subsidiary Duketon are part of a demerger group under subsection 125-65(1) of the ITAA 1997.

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

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

CGT consequences of choosing roll-over

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

Other CGT consequences of choosing roll-over

37. If an STB shareholder chooses roll-over relief, they must also recalculate the cost base and reduced cost base of their STB shares and calculate the cost base and reduced cost base of their Duketon shares.

38. The first element of the cost base and reduced cost base of each STB share and corresponding Duketon share received under the demerger is worked out as follows:

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

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

- attribute 85.36% of the summed cost base to the STB shares; and
- attribute 14.64% of the summed cost base to the Duketon shares.

STB shareholders who do not choose roll-over

40. An STB 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 STB shares under the demerger; and
- the first element of the cost base and reduced cost base of each STB share and the corresponding Duketon share is calculated in the same manner as if they had chosen demerger roll-over relief (see paragraphs 38 and 39 of this Ruling), (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of Duketon shares

41. For the purpose of determining eligibility for a discount capital gain, the Duketon shares received by an STB shareholder are taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding STB 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.

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

Dividend

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

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

44. 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 STB shareholder under the demerger.

45. 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 STB shareholder under the demerger.

Commissioner of Taxation
5 June 2013

Appendix 1 – Explanation

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

46. A significant tax consequence of the scheme is the availability of demerger roll-over relief under Division 125 of the ITAA 1997. Broadly, an STB 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 STB and Duketon shares for an STB shareholder whether or not they choose roll-over relief.

Conditions for demerger roll-over relief

47. 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 own shares in STB;
- the company is the head entity of a demerger group – this requirement is satisfied as STB 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 STB 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 STB shares (see paragraphs 31 and 32 of this Ruling) and STB shareholders received Duketon shares only under the demerger.

48. Under the scheme, the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied. The Ruling section provides a detailed explanation of the Commissioner's decision. Therefore, no further explanation is warranted other than in one aspect of the conditions for roll-over. The relevant issue concerns the treatment of 'adjusting instruments' in determining whether a demerger happens to a demerger group. This matter is explained at paragraphs 49 to 52 of this Ruling.

Adjusting instruments

49. One of the conditions for a demerger happening to a demerger group is the 'proportion' test in subsection 125-70(2) of the ITAA 1997. It requires that each owner of original interests in the head entity must:

- acquire, under the demerger, the same proportion, or as nearly as practicable the same proportion, of new interests in the demerged entity as the original owner owned in the head entity, just before the demerger; and
- just after the demerger, have the same proportionate total market value of ownership interests in the head entity and demerged entity as the original owner owned in the head entity just before the demerger.

50. The options and performance rights are ownership interests for the purposes of this test. However, section 125-75 of the ITAA 1997 provides for various exceptions to the proportion test including, relevantly, an exception for certain 'adjusting instruments' representing not more than 10% of the ownership interests of a listed company (subsections 125-75(4) and 125-75(5) of the ITAA 1997).

51. In determining whether the 10% threshold test is met, adjusting instruments can be measured by reference to either their number or market value in applying subsection 125-75(4) of the ITAA 1997.

52. Although the STB options and performance rights represented over 10% by number of the total ownership interests in STB, they represented less than 10% by value. Further, the exercise price of the options and number of shares to which the performance rights relate were appropriately adjusted taking into account the value of the demerger distribution. Accordingly, it is considered that the STB options and performance rights can be disregarded for the purposes of the proportion test.

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, STB 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 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 45B, 45BA and 45C of the ITAA 1936

58. 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.

59. 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 STB shareholder to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

60. 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

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

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 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- 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
- ITAA 1997 109-5(2)
- ITAA 1997 115-30
- 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 125-70(2)
- ITAA 1997 125-75
- ITAA 1997 125-75(4)
- ITAA 1997 125-75(5)
- 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 Div 197
- ITAA 1997 Div 230
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- TAA 1953
- Copyright Act 1968

ATO references

NO: 1-4BT92KL
ISSN: 1445-2014
ATOlaw topic: Income Tax ~~ Capital Gains Tax ~~ demerger relief