


CR 2015/58 - Income tax: demerger of West Cumbria Mining (Holdings) Limited by Riverside Energy Limited

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Class Ruling

Income tax: demerger of West Cumbria Mining (Holdings) Limited by Riverside Energy Limited

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❶ 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 provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) of the ITAA 1936
- section 45 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- Division 83A of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-135 of the 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 is the holders of ordinary shares and/or options in Riverside Energy Limited (REL) who:

- were listed on the share register of REL on the Record Date (1 June 2015) for the demerger of ordinary shares in West Cumbria Mining (Holdings) Limited (WCMH)
- were listed on the option register of REL on the Record Date to participate in the issue of WCMH options
- on the Record Date did not hold their ordinary shares or options in REL as a revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1)) – that is, they hold their shares or options in REL broadly on capital account, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their ordinary shares in REL.

(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 'REL Interest Holder'.

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 8 to 32 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

7. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

8. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for class ruling dated 29 May 2015 including appendices lodged by Pitcher Partners NSW Pty Limited (the Applicant), and
- all other correspondence from the Applicant in relation to this ruling.

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

9. The subject of this ruling is the demerger transaction involving the distribution of WCMH shares by REL and the issue of options by WCMH occurred on 24 July 2015.

REL

10. REL is an Australian resident public company incorporated on 6 August 2007.

11. As at 30 June 2014, REL had:

- \$4,806,169 issued capital
- \$2,790,527 accumulated losses
- 67,936,222 ordinary shares on issue (REL shares), and
- 21,891,667 share options on issue (REL options).

12. The REL Interest Holders comprise of:
 - 47 resident shareholders and 2 non-resident shareholders, and
 - 17 option holders.
13. Approximately 1.4% of the REL shares are held by non-resident shareholders.
14. REL has never paid any dividends since its incorporation.
15. REL does not have any carried forward net capital losses.

WCMH

16. WCMH is a company incorporated in United Kingdom (UK). Immediately prior to the demerger its shares were approximately 54% owned by REL and the remaining 46% was owned by a third party private equity investor.
17. As at 30 June 2014, REL held 67,936,222 shares in WCMH. The paid up capital in WCMH for the 67,936,222 shares held by REL was £1 (approximately \$2).
18. The market value of REL's 67,936,222 shares in WCMH was \$6,567,035 immediately before the demerger transaction.
19. WCMH accounted for 97.6% of the market value of the REL group.

The demerger transaction

20. On 10 September 2014, the shareholders of REL approved the demerger of WCMH (the Demerger) involving:
 - (a) an *in specie* distribution by REL to its shareholders of 67,936,222 shares in WCMH, and
 - (b) WCMH issuing 21,891,667 share options (WCMH options) to the holders of the REL options.

The in-specie distribution

21. The *in specie* distribution by REL was conducted as a return of capital with the full amount debited to the share capital account of REL. The total amount of the capital return was \$2.
22. The *in specie* distribution by REL to its shareholders was pro rata to their shareholdings in REL on a 1:1 basis – that is, for every one share held in REL, the REL shareholder received one ordinary share in WCMH.
23. Following the Demerger, REL shareholders hold 67,936,222 ordinary shares in REL and 67,936,222 ordinary shares in WCMH.

24. REL's methodology for determining the cost base and reduced cost base of each REL ordinary share and corresponding WCMH ordinary share is as follows:

- attribute 2.4% of the total of the cost bases of the REL ordinary shares just before the demerger to the REL ordinary shares, and
- attribute 97.6% of the total of the cost bases of the REL ordinary shares just before the demerger to the WCMH ordinary shares.

The issue of options in WCMH

25. The WCMH options were issued to align the interests that REL option holders had in REL. They were not issued in relation to REL option holders' employment.

26. The WCMH options were issued on the exact same terms as the REL options, with the exercise price to be apportioned pro rata between the valuations of WCMH and REL respectively, as determined by the REL's board of directors. The tax cost bases of the REL options and the WCMH options were apportioned on the same basis.

27. The WCMH options were issued on the same date as the *in specie* distribution of WCMH shares by REL to REL shareholders.

28. Following the Demerger, REL option holders hold 21,891,667 options in REL and 21,891,667 options in WCMH.

29. REL's methodology for determining the cost base and reduced cost base of each REL option and corresponding WCMH option is as follows:

- attribute 2.4% of the total of the cost bases of the REL options just before the demerger to the REL options, and
- attribute 97.6% of the total of the cost bases of the REL options just before the demerger to the WCMH options.

Reasons for the Demerger

30. REL have advised that the key drivers for the Demerger were:

- to increase management focus on the separate groups
- to enable each separate group to pursue its own growth agenda and strategic priorities
- to enable each group to allocate its own capital resources and to attract third party funding, and
- to recognise the different investment profiles of the two companies and hence the provision of investor choice.

Other matters

31. REL's share capital account is not tainted within the meaning of Division 197.

32. REL has not made an election under subsection 44(2) of the ITAA 1936.

Ruling

CGT Consequences- Australian resident REL shareholders

CGT event G1

33. CGT event G1 in (section 104-135) happened in respect of each REL share owned by an Australian resident REL shareholder at the time REL made the payment of the capital reduction amount (satisfied by the *in specie* distribution of WCMH shares).

Capital gain

34. An Australian resident REL shareholder made a capital gain when CGT event G1 happened if the capital reduction amount for each REL share exceeded the cost base of that share. No capital loss can be made from CGT event G1 (subsection 104-135(3)).

Demerger roll-over

35. A demerger, as defined in section 125-70, happened to the REL demerger group (which included REL and WCMH) under the scheme that is the subject of this Ruling.

36. The resident REL shareholders are eligible to choose demerger roll-over relief contained in Division 125.

Consequences of choosing demerger roll-over

37. An Australian resident REL shareholder who chooses demerger roll-over:

- will disregard any capital gain made when CGT event G1 happened under in relation to each of their REL shares under the demerger (subsection 125-80(1)), and
- must recalculate the first element of the cost base and reduced cost base of their REL shares, and calculate the first element of the cost base and reduced cost base of the new WCMH shares they acquired under the demerger (subsection 125-80(2)).

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

- taking the total of the cost bases of each REL ordinary shares just before the demerger, and
- apportioning that total between the REL ordinary shares and the WCMH ordinary shares acquired under the demerger.

39. The apportionment of this total is done on a reasonable basis having regards to the market values (just after the demerger) of the REL and WCMH ordinary shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3)).

Consequences of not choosing demerger roll-over

40. A REL shareholder who does not choose demerger roll-over:

- cannot disregard a capital gain made when CGT event G1 happened under the demerger to their REL ordinary shares, and
- must recalculate the first element of the cost base and reduced cost base of their REL ordinary shares, and calculate the first element of the cost base and reduced cost base of the WCMH ordinary shares they acquired under the demerger (subsections 125-85(1) and (2)).

Acquisition date of the WCMH ordinary shares

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

CGT consequences- foreign resident REL shareholders

CGT event G1

42. CGT event G1 in section 104-135 happened in respect of each REL ordinary share owned by a foreign resident REL shareholder at the time REL made the payment of capital reduction amount (satisfied by distributing the WCMH ordinary shares).

Capital Gain

43. A foreign resident REL shareholder will make a capital gain from CGT event G1 happening if the capital reduction amount for each REL share is more than the cost base of the REL 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 is not available

44. A foreign resident REL shareholder cannot choose to obtain demerger roll-over under Division 125 because the WCMH ordinary shares they acquired under the demerger were not taxable Australian property just after they acquired them (subsection 125-55(2)).

Foreign resident REL shareholders whose ordinary shares were not taxable Australian property

45. A foreign resident REL shareholder can disregard a capital gain made from CGT event G1 happening under the demerger in respect of a REL ordinary share, unless:

- the REL ordinary share has been used at any time by them in carrying on a business through a permanent establishment in Australia (Item 3 of the table in section 855-15), or
- the REL ordinary share is covered by subsection 104-165(3) (Item 5 of the table in section 855-15).

Cost base and reduced cost base of REL shares and WCMH shares

46. A foreign resident REL shareholder must recalculate the first element of the cost base and reduced cost base of their REL shares, and calculate the first element of the cost base and reduced cost base of the WCMH shares they acquired under the demerger (subsections 125-85(1) and (2)).

Dividend Consequences***Distribution of capital is not a dividend***

47. To the extent that the *in-specie* distribution to REL shareholders of WCMH shares under the scheme is debited to the share capital account of REL (that is, \$2), it is not a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

Demerger dividend

48. To the extent that the balance of the *in-specie* distribution (that is, \$6,567,033) to REL shareholders of WCMH shares is a dividend, it will be a demerger dividend (subsection 6(1) of the ITAA 1936).

49. REL shareholders received a demerger dividend consisting of a pro rata share of excess of the money value of the *in-specie* distribution of WCMH shares over the amount debited to the share capital account of REL (see Taxation Ruling TR 2003/8).

50. The demerger dividend is neither assessable income nor exempt income of Australian resident and foreign resident REL shareholders for Australian tax purposes (subsections 44(3) and 44(4) of the ITAA 1936).

CGT Consequences – REL option holders***Cost base and reduced cost base of REL options and WCMH options***

51. A REL option holder must recalculate the first element of the cost base and reduced cost base of their REL option, and calculate the first element of the cost base and reduced cost base of the WCMH option they acquired under the demerger (subsections 125-90(1) and (2)).

Acquisition date of the WCMH options

52. The option holder has acquired the WCMH options on the date (24 July 2015) that the option was granted (subsection 109-5(2)).

WCMH options and Employee Share Schemes

53. Subsection 83A-10(2) will not apply to the issue of WCMH options under the demerger. This is because the WCMH options were issued in respect of the demerger rather than the employment of REL option holders.

Application of sections 45, 45A and 45B of the ITAA 1936

54. Section 45 of the ITAA 1936 will not apply to the whole or any part of the demerger distribution provided to the REL shareholders under the demerger.

55. Section 45A of the ITAA 1936 will not apply to the whole or any part of any demerger benefit provided to REL shareholders and the Commissioner will not make a determination under subsection 45A(2) that section 45C of the ITAA 1936 applies.

56. 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 REL shareholders under the demerger.

57. 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 REL shareholders under the demerger.

Commissioner of Taxation

5 August 2015

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.*

Demerger roll-over

58. 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 demerger of WMCH ordinary shares by REL are:

- (a) An entity owns a share in a company
- (b) the company is the head entity of a demerger group
- (c) a demerger happens to the demerger group
- (d) under the demerger, a CGT event happens to the original interest and the entity acquires a new or replacement interest in the demerged entity (which must be a company) only because they own the original interest, and acquire nothing else, and
- (e) the entity owning the original interest must acquire, under the demerger, the same proportion of new interests in the demerged entity as they owned in the head entity just before the demerger.

59. The conditions for choosing demerger roll-over under Division 125 were satisfied in respect of the demerger of WCMH shares. Accordingly, the demerger concessions in Division 125 are available to Australian resident REL shareholders in respect of the demerger of WCMH shares. If an Australian resident REL shareholder chooses demerger roll-over, they must recalculate the cost base and reduced cost base of their REL shares and calculate the cost base and reduced cost base of their new WCMH shares (section 125-80).

60. A foreign resident REL shareholder cannot choose to obtain demerger roll-over under Division 125 because the WCMH ordinary shares they acquired under demerger were not taxable Australian property just after they acquired them (subsection 125-55(2)). However, a foreign resident REL shareholder must recalculate the cost base and reduced cost base of their REL shares and calculate the cost base and reduced cost base of their new WCMH shares (section 125-85).

61. REL option holders acquired the WCMH options under the Demerger. Because there was no CGT event happened to their REL options (that is, the original interests), they must recalculate the cost base and reduced cost base of their REL options and calculate the cost base and reduced cost base of their new WCMH options under section 125-90.

Distribution debited to the share capital account is not a dividend

62. 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 shareholder out of profits derived by the company from any source (if the shareholder is an Australian resident) or out of profits derived by the company from sources in Australia (if the shareholder is a non-resident).

63. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes a distribution made by a company to any of its shareholders, whether in money or other property. However, paragraph (d) of the definition of 'dividend' excludes a distribution that is debited against an amount standing to the credit of the share capital account of the company.

64. 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.

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

66. The *in specie* distribution to REL shareholders of WCMH shares has been recorded as a debit to REL's share capital account. As the share capital account of REL 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 *in specie* distribution to REL shareholders of WCMH shares, being debited to the 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 REL shareholders under subsection 44(1) of the ITAA 1936.

Balance of the distribution is a demerger dividend

67. REL shareholders received a dividend (the demerger dividend) to the extent that the market value of the REL shares distributed under the demerger exceeded the amount of the distribution debited against the share capital account (see Taxation Ruling TR 2003/8).

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

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

69. As each of the conditions in paragraph 68 of this Ruling are satisfied, the demerger dividend received by REL shareholders will not be assessable income or exempt income (subsection 44(4) of the ITAA 1936).

WCMH options and Employee Share Schemes

70. Division 83A does not apply to the acquisition of WCMH options by a REL option holder under the demerger because the REL option holder does not acquire the WCMH option under an employee share scheme within the meaning of subsection 83A-10(2).

71. Under subsection 83A-10(2), an employee share scheme is defined as a scheme under which ESS interests in a company are provided to employees (or associates of employees) of the company or subsidiaries of the company, in relation to the employee's employment.

72. The scheme under which WCMH options are acquired by REL option holders is the demerger under which all eligible REL option holders on a designated record date will acquire a WCMH option because they hold a REL option. The WCMH option is acquired by a REL option holder in relation to their ownership of a REL option and as a consequence of the demerger, rather than in relation to their employment.

Application of sections 45, 45A and 45B of the ITAA 1936

Section 45

73. 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% (subsection 45(3) of ITAA 1936).

74. Considering the circumstances of the demerger, the Commissioner is of the view there was no streaming of shares and minimally franked dividend. Therefore section 45 of the ITAA 1936 will not apply to the whole or any part of any demerger allocation received by REL shareholders.

Section 45A

75. 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.

76. Although a 'capital benefit', as defined in paragraph 45A(3)(b)) of ITAA 1936, is provided to REL shareholders as part of the demerger distribution, all shareholders will benefit equally and there is no indication of 'streaming' of capital benefits to some shareholders and dividends to others.

77. Therefore, section 45A of ITAA 1936 will not apply to the whole or any part of any capital benefits provided to REL shareholders and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies.

Section 45B

78. 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 demerger allocation or return of capital received by shareholders is to be treated as an unfranked dividend.

79. 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), and
- (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).

80. The arrangement involving the *in specie* distribution to REL shareholders of WCMH shares constitutes a scheme for the purposes of section 45B of the ITAA 1936.

81. 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 WCMH shares means that REL shareholders will be taken to have been provided with a demerger benefit, and provided with a capital benefit.

82. The Commissioner considers that at least some REL shareholders obtained a tax benefit (within the meaning given by subsection 45B(9) of the ITAA 1936) under the scheme.

83. 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 to obtain a tax benefit. Having regard to the relevant circumstances as outlined in subsection 45B(8) of the ITAA 1936, the Commissioner has formed the view that such a purpose did not exist.

84. 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 REL shareholders under the demerger of WCMH shares
- 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 REL shareholders under the demerger of WCMH shares.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- acquisition dates
- capital gains
- CGT events
- CGT events G1-G3 – shares
- CGT capital proceeds
- CGT taxable Australian property
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger roll-over
- demerger subsidiary
- return of capital on shares

- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)(a)
- ITAA 1936 45B(3)(b)
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ATO references

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