


CR 2017/37 - Income tax: demerger of Alcoa Corporation from Alcoa Inc. (now Arconic Inc.)

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Class Ruling

Income tax: demerger of Alcoa Corporation from Alcoa Inc. (now Arconic Inc.)

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① 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.

Summary – what this ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) 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)
- section 44 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
- Division 104 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 115-30 of the ITAA 1997

- Division 125 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is shareholders of Alcoa Inc., now named Arconic Inc., who:

- (a) were listed on the share register of Alcoa Inc. as at the Record Date for the distribution of shares in Alcoa Corporation (AC). The Record Date was the close of business on 20 October 2016 (Eastern Time, United States of America (US))
- (b) did not hold their shares in Alcoa Inc. as revenue assets (as defined in section 977-50 of the ITAA 1997) nor as trading stock (as defined in subsection 995-1(1)) – that is, broadly they were held on capital account at the distribution date. The distribution date was 1 November 2016 (Eastern Time, US)
- (c) held their Alcoa Inc. shares that were post-CGT assets;
- (d) were ‘resident of Australia’ as defined in subsection 6(1) of the ITAA 1936 on the distribution date, and
- (e) are not subject to the taxation of financial arrangement rules in Division 230 of the ITAA 1997. (Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

Qualifications

4. 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 7 to 28 of this Ruling.

5. 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

6. This Ruling applies from 1 July 2016 to 30 June 2017. The Ruling continues to apply after 30 June 2017 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

7. 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:

- Class Ruling Application dated 20 March 2017.

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

Introduction

8. On 1 November, 2016 (Eastern Time, US), Alcoa Inc. (Alcoa) carried out a demerger of 80.1% of the shares in its wholly owned subsidiary, Alcoa Corporation (AC).

9. After the demerger, Alcoa changed its name to Arconic Inc. (Arconic).

10. Alcoa (now Arconic) is a US company listed on the New York Stock Exchange (NYSE).

11. In September 2015, Alcoa announced that it intended to separate into two independent, publicly traded companies:

- (a) One company would consist of Alcoa's 'upstream' businesses, including its bauxite, alumina, aluminium, casting and energy assets, as well as the Warrick, IN rolling operations and the equity interest in the rolling mill at the joint venture in Saudi Arabia.
- (b) A second company would include its Global Rolled Products (excluding the Warrick, IN rolling operations and the equity interest in the rolling mill at the joint venture in Saudi Arabia), Engineered Products and Solutions, and Transportation and Construction Solutions businesses (the 'value added' businesses).

Reasons for the demerger

12. The commercial justifications for the demerger were contained in the announcement by the Alcoa board dated 28 September 2015:

'The Value-Add Company and Upstream Company will have distinct value profiles with the ability to effectively allocate resources and deploy capital in-line with individual growth priorities and cash-flow profiles. As independent entities, each company will be positioned to capture opportunities in increasingly competitive and rapidly evolving markets. The separation will enable both the Value-Add Company and Upstream Company to pursue their own independent strategies, pushing the performance envelope within distinct operating environments'.

Ownership interests in Alcoa Inc.

13. As at 30 June 2016, Alcoa had on issue:

- 1,315,141,710 common shares
- 546,024 Class A Preferred Shares
- 2,500,000 Class B Preferred Shares
- 28,371,634 RTI Convertible Notes
- a number of Employee Stock Options and Awards issued under employee share schemes to which Subdivision 83A-C of the ITAA 1997 applies, and
- a number of treasury shares which were cancelled in August 2016, prior to the demerger.

14. Just before the demerger, approximately 0.3% of the issued share capital of Alcoa was held by shareholders who disclosed an Australian address.

15. Just before the demerger, the total of Class A Preferred Shares, Class B Preferred Shares and RTI Convertible Notes, represented less than 10% of the total ownership interests in Alcoa.

16. Just before the demerger, Employee Stock Options and Awards represented less than 3% of the total ownership interests in Alcoa.

Pre-demerger steps

17. To facilitate the demerger, Alcoa incorporated a new company, Alcoa Corporation (AC). AC was a wholly owned subsidiary of Alcoa at its incorporation.

18. Alcoa then undertook various intra-group transaction to ensure that AC held, directly or indirectly, all companies and assets comprising of the upstream businesses.

The demerger

19. On 1 November 2016 (Eastern Time, US) the demerger was effected by way of Alcoa making an in specie distribution of 80.1% of shares in AC to Alcoa shareholders.

20. The distribution was made on a pro rata basis. Alcoa shareholders received one share of AC common stock for every three shares of Alcoa common stock held as of the Record Date for the distribution.

21. To account for the distribution of AC shares, Alcoa reduced its retained earnings in compliance with US Generally Accepted Accounting Practice (GAAP).

22. The amount of the reduction was US\$8,692,444,735 equal to the difference between the book value of the total assets and the liabilities (net book value) of AC and its wholly owned subsidiaries (the AC group), multiplied by the distribution percentage, being 80.1%.

Other matters

23. The five day volume weighted average share price (VWAP) for Arconic (formerly named Alcoa) and AC based on trading on the NYSE over the five days following the demerger was US\$18.34 and US\$23.63, respectively.

24. Alcoa and its subsidiaries are not demerger subsidiaries of another demerger group as no company or trust owns or has the right to acquire more than 20% of Alcoa's shares.

25. No members of the Alcoa group own shares in Alcoa.

26. Participating shareholders will not be able to obtain roll-over relief outside Division 125 of the ITAA 1997.

27. There was no off-market buy-back of shares (as defined in Division 16K of Part III of the ITAA 1936) under the scheme.

28. This Ruling is made on the following basis:

- (a) Alcoa will not make an election under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 do not apply to the total demerger dividend for all shareholders
- (b) just after the demerger, at least 50% by market value, of all the CGT assets owned by AC and its 'demerger subsidiaries' (as defined in s125-65(6) of the ITAA 1997) will be used, directly or indirectly, in a business carried on by one or more of those entities in satisfaction of subsection 44(5) of the ITAA 1936
- (c) all the Alcoa shares owned by Australian resident shareholders were 'post CGT assets', that is, they were acquired after 19 September 1985, and

- (d) the retained earnings of Alcoa/Arconic which is based on US accounting requirements is broadly equivalent to retained earnings from an Australian accounting perspective, being an accumulation of profits without any part of it being sourced from paid up capital.

Ruling

Demerger roll-over relief

29. Demerger roll-over relief enables a shareholder to choose to disregard a capital gain made as a result of a CGT event that happens to their shares in the original company under a demerger.

30. A demerger, as described under section 125-70 of the ITAA 1997, happened under the scheme and a CGT event happened in relation to each of the Alcoa shares owned by Alcoa shareholders.

31. Therefore, Alcoa shareholders can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their shares.

Alcoa shareholders who choose demerger roll-over

32. An Alcoa shareholder who chooses demerger roll-over:

- will disregard any capital gain or loss made when the CGT event happens in relation to each of their Alcoa shares under the demerger (subsection 125-80(1) of the ITAA 1997), and
- must recalculate the cost base and reduced cost base of their Alcoa shares and AC shares (subsection 125-80(2) of the ITAA 1997).

33. The first element of the cost base and reduced cost base of each Alcoa share and corresponding AC shares received under the demerger is worked out as follows:

- take the sum of the cost bases of the Alcoa shares (just before the demerger), and
- apportion that sum over the Alcoa shares and corresponding new AC shares received under the demerger.

34. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Alcoa and AC shares, or a reasonable approximation of those market values (subsection 125-80(2) and 125-80(3) of the ITAA 1997).

35. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3) of the ITAA 1997, the Commissioner accepts the volume weighted average price of the AC shares and Alcoa shares as traded in the ordinary course of trading on the New York Stock Exchange (NYSE) over the first five trading days from the demerger date (1 November 2016) as a reasonable approximation of the relative market value of those shares.

36. Based on the volume weighted average prices calculated (in paragraph 23 above) and the distribution ratio under the demerger of one AC share for every three Alcoa shares held (paragraph 20 above), the Commissioner accepts that a reasonable apportionment of the total cost base of the Alcoa shares just before the demerger is to:

- (a) attribute 30.04% of the total cost base or reduced cost base to the AC shares just after the demerger, and
- (b) attribute 69.96% of the total cost base or reduced cost base to the Alcoa (now Arconic) shares just after the demerger.

Alcoa shareholders who do not choose demerger roll-over

37. Alcoa shareholders who do not choose to obtain demerger roll-over relief:

- cannot disregard any capital gain made when the CGT event happens in relation to their Alcoa shares under the demerger
- may make a capital gain from the CGT event. However, any capital gain made will be reduced to nil by the CGT anti-overlap rule (subsection 118-20(4) of the ITAA 1997), and
- must calculate the first element of the cost base and reduced cost base of their Alcoa shares and the corresponding AC shares in the same manner described in paragraphs 34 to 36 of this Ruling (subsections 125-85(1) and (2) of the ITAA 1997).

Acquisition date of the AC shares for the purposes of the CGT discount

38. For the purpose of determining eligibility for a discount capital gain under Subdivision 115-A of the ITAA 1997, AC shares received by an Alcoa shareholder under the demerger will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the original corresponding Alcoa shares (subsection 115-30(1) of the ITAA 1997). This will be the case whether or not the shareholder chooses demerger roll-over.

Dividend consequences

39. The distribution of AC shares constitutes both a demerger allocation and a dividend (subsection 6(1) of the ITAA 1936). As no part of the demerger allocation was debited to Alcoa's share capital account, the distribution is entirely a demerger dividend (subsection 6(1) of the ITAA 1936).

40. The demerger dividend is not assessable income or exempt income of Alcoa shareholders (subsection 44(4) of the ITAA 1936).

Section 45A of the ITAA 1936

41. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in respect of the whole, or any part, of the distribution of AC shares to Alcoa shareholders under the demerger.

Section 45B of the ITAA 1936

42. The Commissioner will not make a determination under section 45B of the ITAA 1936 that either section 45BA of the ITAA 1936 or section 45C of the ITAA 1936 applies to the whole or any part of the distribution of AC shares to Alcoa shareholders under the demerger.

Commissioner of Taxation

28 June 2017

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

43. The demerger roll-over provisions in Division 125 of the ITAA 1997 contain a number of conditions for eligibility to choose roll-over. The main conditions that are relevant to the demerger of AC are:

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

44. The conditions for choosing demerger roll-over under Division 125 are satisfied in respect of the demerger of AC. As a consequence, the demerger concessions outlined in Division 125 and in subsections 44(3) and (4) of the ITAA 1936, are available to Alcoa shareholders in respect of the demerger of AC.

Demerger Dividend

45. A dividend is defined in subsection 6(1) of the ITAA 1936 to include a distribution made by a company, other than a distribution debited against an amount standing to the credit of the share capital account of that company.

46. No part of the Alcoa distribution will be debited to Alcoa's share capital account. Therefore, the entire value of the distribution will constitute a dividend.

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

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

48. As each of the conditions are satisfied, the demerger dividend received by Alcoa shareholders will not be assessable income or exempt income (subsection 44(4) of the ITAA 1936).

Application of sections 45A of the ITAA 1936

49. 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.

50. Under the demerger, there was no 'streaming' of capital benefits to some shareholders and not to others.

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

Application of sections 45B of the ITAA 1936

52. The purpose of section 45B of the ITAA 1936 as set out in subsection 45B(1) of the ITAA 1936 is to ensure that relevant amounts distributed to shareholders of a company are treated as dividends for tax 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.

53. Subsection 45B(2) of the ITAA 1936 provides that the section applies if:

- (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))
- (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)), 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)).

54. 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 (Alcoa shareholders) to obtain a tax benefit. Having regard to the relevant circumstances, and on the basis of the information provided, the Commissioner has concluded that the scheme was not entered into or carried out for a more than incidental purpose of obtaining a tax benefit.

55. Therefore, the Commissioner will not make a determination under section 45B of the ITAA 1936 that either section 45BA of the ITAA 1936 or section 45C of the ITAA 1936 applies to the whole or any part of the distribution of AC shares to Alcoa shareholders under the demerger.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

- ITAA 1936 45B(8)
- ITAA 1936 45BA
- ITAA 1936 45C

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

- ITAA 1997
- ITAA 1997 Div 104
- ITAA 1997 109-5
- ITAA 1997 Div 110

Legislative references:

- ITAA 1936
- ITAA 1936 Div 16K Pt III
- ITAA 1936 6(1)
- ITAA 1936 44
- ITAA 1936 44(2)
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 44(5)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45B
- ITAA 1936 45B(1)
- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)

- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-30
- ITAA 1997 115-30(1)
- ITAA 1997 Div 125
- ITAA 1997 125-55(1)
- ITAA 1997 125-65(6)
- ITAA 1997 125-70
- 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 230
- ITAA 1997 977-50
- ITAA 1997 995-1(1)
- TAA 1953

ATO references

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rules ~~ Section 45C

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