

# ***CR 2005/16 - Income tax: capital gains: demerger of NGM Resources Limited by Aviva Corporation Limited***

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## Class Ruling

# Income tax: capital gains: demerger of NGM Resources Limited by Aviva Corporation Limited

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### **Preamble**

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

## **What this Class Ruling is about**

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

### **Tax law(s)**

2. The tax laws dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 6D of the 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 109-10 of the ITAA 1997;
- Division 115 of the ITAA 1997; and
- Division 125 of the ITAA 1997.

## Class of persons

3. The class of persons to which this Ruling applies is the ordinary shareholders of Aviva Corporation Limited (Aviva) who were registered as ordinary shareholders (Aviva shareholders) on 17 September 2004 (their shares are referred to as Aviva Shares).

## Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 24.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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## Date of effect

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8. This Ruling applies to the year of income ended 30 June 2005 or substituted accounting period. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

## Withdrawal

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9. This Ruling is withdrawn from immediately after 30 June 2005. This Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the arrangement during the term of the Ruling.

## Arrangement

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10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

1. Letter dated 4 June 2004 from Ernst & Young requesting the issue of a Class Ruling, pursuant to section 14ZAAF of the *Tax Administration Act 1953*, together with annexures comprising:
  - Notice of general meeting of Aviva shareholders to be held subsequent to the Class Ruling (in draft form);
  - Explanatory Statement in relation to the General Meeting;
  - Aviva Options Prospectus dated 21 March 2003;
  - Aviva Options Prospectus dated March 2000;
  - 2000 and 2003 Annual Reports for Aviva; and
  - Aviva's Form 603 'Notice of initial substantial holder' in NGM Resources Limited.
2. Letter dated 11 August 2004 from Ernst & Young providing further details of the arrangement, and including annexures comprising:
  - Appendix A – terms and conditions of issue of Options issued by NGM;
  - Appendix B – escrow conditions attaching to in specie distribution of NGM Shares to Aviva shareholders; and
  - Appendix E – final version of Notice of general meeting and explanatory statement.
3. Email dated 1 December 2004 from Ernst & Young outlining the Class of Persons to which the Ruling applies.
4. Letter dated 10 February 2005 from Ernst & Young providing further explanation of the demerger process.

**Note:** certain information received from Ernst & Young on behalf of Aviva may have been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

11. Aviva is an Australian resident company listed on the Australian Stock Exchange (ASX). It acquired 6.5 million shares in NGM in December 2003, as a result of assigning Aviva's 50% participating interest in a gold exploration joint venture. The shares were issued by NGM at a deemed issue price of \$0.046 per share.
12. Aviva's 6.5 million shares in NGM represents an interest of 20.31% in NGM, based on Aviva's shareholding as a percentage of NGM's issued shares.
13. On 27 February 2004, Aviva announced NGM's initial public offering (IPO), and that Aviva intended distributing in specie, the shares in NGM it had received as consideration for assigning its gold assets to NGM, subject to the successful IPO.
14. On 3 May 2004, NGM was listed on the ASX.
15. The demerger of NGM will occur by way of a capital reduction whereby Aviva will reduce its share capital by the book value of its NGM shares, amounting to \$300,000 (6.5 million shares at \$0.046 per share).
16. The NGM shares represented approximately 15.2% of the value of Aviva, using market capitalisation of NGM and Aviva shares as at 3 August 2004.
17. The result of the demerger will be that Aviva shareholders will own shares in both Aviva and NGM. Aviva shareholders will receive one NGM share for every 37 Aviva shares owned.
18. Aviva has on issue approximately 100 million listed options exercisable up until 31 December 2005, and just over 7 million unlisted options exercisable up until 27 March 2005.
19. Just before the demerger, it is expected that the options will represent not more than 10% of the ownership interests in Aviva, taking into account their value.
20. Option holders will not be granted any ownership interests in NGM, but the exercise price of each option will be reduced by the amount of the return of capital on each fully paid share. The reduction as a result of the demerger is expected to be approximately \$0.005 for each option exercised.
21. No profits in respect of its shares in NGM were recognised in Aviva's accounts. The demerger will not result in a dividend for accounting purposes, and the in specie distribution of the NGM shares will be recorded in Aviva's financial accounts as a return of capital.
22. The amount of the capital reduction will be \$300,000, which is equivalent to approximately \$0.0012 per share based on the issued capital of 240,657,643 Aviva shares.

23. There are escrow restrictions attaching to the 6.5 million NGM shares held by Aviva, which preclude Aviva from disposing of the NGM shares for a fixed period other than in specific circumstances, of which the proposed demerger is one. However, it is a requirement of the transaction that the same disposal restrictions, that is, the escrow, continues in relation to the NGM shares when they are held by Aviva shareholders.

24. The NGM shares will be distributed to Aviva shareholders under Resolution 1 of the proposed general meeting of Aviva shareholders. After the demerger, and to comply with the escrow restrictions, the Aviva shareholders will instruct the directors of Aviva under Resolution 2 to hold their NGM shares on trust until the escrow period ends.

## **Ruling**

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25. Aviva and its subsidiary NGM constitute a demerger group under subsection 125-65(1) of the ITAA 1997.

26. A demerger will happen to the Aviva group under section 125-70 of the ITAA 1997.

27. CGT event G1 (section 104-135 of the ITAA 1997) will happen to each of the shares of the Aviva shareholders at the time of the reduction of capital.

28. Aviva shareholders will be eligible to choose roll-over relief to defer capital gains tax (CGT) consequences for the CGT events that happen to their Aviva shares under the demerger under subsection 125-55(1) of the ITAA 1997. Capital gains or losses made by Aviva shareholders who choose roll-over relief in respect of CGT event G1 (section 104-135 of the ITAA 1997) happening to their Aviva shares will be disregarded under subsection 125-80(1) of the ITAA 1997.

29. If a shareholder chooses roll-over relief, under subsection 125-80(2) of the ITAA 1997, the first element of the cost base and reduced cost base of each Aviva share acquired on or after 20 September 1985 and before the demerger date (post-CGT Aviva shares) and the corresponding NGM shares acquired under the demerger will be the sum of the cost base of the post-CGT shares, apportioned on a reasonable basis having regard to the market values of the remaining original interests and new interests, or a reasonable approximation of the market values of those interests, just after the demerger (subsection 125-80(3) of the ITAA 1997).

30. If a shareholder does not choose roll-over relief, the same adjustments are made, under subsections 125-85(1) and (2) of the ITAA 1997, to the first element of the cost base and reduced cost base of each post-CGT Aviva share and the corresponding NGM share acquired under the demerger, as would be made if those shareholders had chosen roll-over relief under section 125-80 of the ITAA 1997.

31. Aviva shareholders who choose roll-over and who acquired some or all of their Aviva shares before 20 September 1985 will be taken to have acquired a corresponding number of their NGM shares before that day (subsection 125-80(6) of the ITAA 1997).

32. Under subsection 115-30(1) of the ITAA 1997 (Item 2) for discount capital gains tax calculation purposes, the acquisition date of the NGM shares acquired under the demerger will be the date each shareholder acquired their Aviva shares.

33. Any dividend arising under the demerger will be a demerger dividend (subsection 6(1) of the ITAA 1936) and by operation of subsections 44(3) and 44(4) of the ITAA 1936, no part of the demerger dividend will be assessable as a dividend to Aviva shareholders under subsection 44(1) of the ITAA 1936.

34. 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 Aviva shareholders under the demerger. 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 Aviva shareholders under the demerger.

## Explanation

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35. In order for the demerger concessions in Division 125 of the ITAA 1997 to be considered there must be a demerger group (subsection 125-65(1) of the ITAA 1997) that a demerger happens to (subsection 125-70(1) of the ITAA 1997).

### Demerger group

36. A demerger group (Aviva/NGM demerger group) comprises one head entity and at least one demerger subsidiary (subsection 125-65(1) of the ITAA 1997). The demerger group in this case comprises Aviva as the head entity and NGM as its demerger subsidiary.

37. Aviva is the head entity because:

- NGM has no ownership interests in Aviva (subsection 125-65(3) of the ITAA 1997); and
- there is no other entity that is capable of being a head entity having NGM as a demerger subsidiary (subsection 125-65(4) of the ITAA 1997).

38. NGM is a demerger subsidiary of Aviva because Aviva owns ownership interests in NGM that carry more than 20% of the rights to income and capital (subsection 125-65(6) of the ITAA 1997).

**Demerger**

39. A demerger (subsections 125-70(1) to (3) of the ITAA 1997) happens to the Aviva/NGM demerger group and the demerger concessions will be available as:

- there will be a restructuring (paragraph 125-70(1)(a) of the ITAA 1997), and Aviva will dispose of at least 80% of its NGM shares to owners of original interests in Aviva (subparagraph 125-70(1)(b)(i) of the ITAA 1997);
- CGT event G1 will happen to original interests (Aviva shares) in the head entity and the Aviva shareholders will acquire new shares in NGM and nothing else (subparagraph 125-70(1)(c)(i) of the ITAA 1997);
- the arrangement is structured such that the NGM shares will be provided on the basis of the ownership of the original interests in Aviva. This satisfies paragraph 125-70(1)(d) and subparagraph 125-70(1)(e)(i) of the ITAA 1997;
- paragraphs 125-70(1)(f) and (g) of the ITAA 1997 will be satisfied;
- the NGM shares will be distributed to the Aviva shareholders on the basis of their original shareholdings, and the requirements of paragraph 125-70(2)(a), together with section 125-75, of the ITAA 1997 will be satisfied;
- the total market value of the shares in each of Aviva and NGM just after the demerger are expected to be reasonably proportionate to the market value of the Aviva shares before the demerger (paragraph 125-70(2)(b) of the ITAA 1997);
- there is no share buy-back involved (subsection 125-70(4) of the ITAA 1997); and
- there is no roll-over available under another provision of the tax law (subsection 125-70(5) of the ITAA 1997).

40. The options are adjusting instruments for the purposes of subsection 125-75(4) and (5) of the ITAA 1997.

41. CGT event G1 under section 104-135 of the ITAA 1997 will happen to the Aviva shares on the demerger date. It is unlikely that a capital gain will arise upon the happening of the G1 event because the return of capital is unlikely to exceed the cost bases of the Aviva shareholders. As such, there is unlikely to be a capital gain to roll-over (subsection 125-80(1) of the ITAA 1997).

42. The existence of the escrow restrictions in relation the NGM shares acquired by the Aviva shareholders under the demerger does not affect the application of the demerger provisions in Division 125 of the ITAA 1997.

**Cost base adjustments**

43. The method of calculating a new cost base for the original Aviva shares and new NGM shares is the same whether or not roll-over is chosen (subsections 125-80(2) and (3), subsection 125-85(2) and Note 1 to subsection 125-80(2) of the ITAA 1997).

44. The Aviva shareholders must spread the original cost base for their Aviva shares over their Aviva shares and the new NGM shares, on the basis of the relative market values of those shares (subsections 125-80(2) and (3) of the ITAA 1997). Aviva has advised that it will provide a basis for apportionment to Aviva shareholders as soon as practicable after the demerger.

**Time of acquisition of NGM shares – CGT discount**

45. For general capital gains tax purposes, shareholders will acquire their NGM shares when those shares are received under the demerger (section 109-10 of the ITAA 1997). However, for the purpose of accessing the CGT discount in Division 115 of the ITAA 1997, NGM shareholders will be taken to have acquired their NGM shares on the date they acquired their corresponding Aviva shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). One of the conditions that must be satisfied before a capital gain can be reduced by the discount percentage is that it relates to an asset that was owned for at least 12 months (subsection 115-25(1) of the ITAA 1997).

**Demerger allocation and demerger dividend**

46. The demerger measure exempts from tax certain dividends arising under a demerger. Integrity rules limit this exemption where there is a scheme that is entered into for the purpose of obtaining that non-assessable dividend (demerger dividend).

47. The demerger dividend is that part of the demerger allocation that, but for the operation of subsections 44(3) and 44(4) of the ITAA 1936, would be assessable income of the Aviva shareholders under subsection 44(1) (subsection 6(1) of the ITAA 1936). The demerger allocation is the total market value of the new interests in the demerged entity acquired under the demerger (subsection 6(1)).

48. In the circumstances of this demerger, Aviva will debit the capital distribution against the amount standing to the credit of the 'share capital account' as defined in section 6D of the ITAA 1936. That amount will therefore not constitute a dividend for the purposes of subsection 6(1) of the ITAA 1936 and will not be assessable as a subsection 6(1) dividend under subsection 44(1) of the ITAA 1936.

49. However, if the value of the NGM shares distributed under the demerger exceeds the amount debited against the share capital account, a dividend will arise (see Taxation Ruling TR 2003/8). Subject to the integrity rules in section 45B of the ITAA 1936 (see paragraphs 50 to 54), this dividend is neither an assessable dividend nor an exempt income amount of the Aviva shareholders (subsections 44(3) and 44(4) of the ITAA 1936) because:

- the dividend amount is a demerger dividend (as defined in subsection 6(1) of the ITAA 1936;
- Aviva will not make an election that subsections 44(3) and 44(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 because more than 50% of the market value of the CGT assets owned by NGM will be used in the carrying on of a business by NGM.

#### **Section 45B – schemes to provide certain benefits**

50. 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 a demerger; or
- (b) certain payments, allocations and distributions are made in substitution for dividends.

51. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a demerger benefit or capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
- 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
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme 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).

52. The provision of ownership interests in a company, a distribution or the doing of a thing in relation to an ownership interest that has the effect of increasing the value of an ownership interest owned by the person which occurs under a demerger may be considered to be a demerger benefit and a capital benefit for the purposes of section 45B (subsections 45B(4) and 45B(5) of the ITAA 1936). However, if the provision of interests, the distribution or the thing done involves the person receiving a demerger dividend then, to that extent, it cannot be treated as a capital benefit (subsection 45B(6) of the ITAA 1936). Accordingly, to the extent that the demerger benefit does not involve the receipt of a demerger dividend it will constitute both a demerger benefit and a capital benefit.

53. 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 Aviva shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present. In other words, having regard to the relevant circumstances of the scheme, set out in subsection 45B(8) of the ITAA 1936, it would not be concluded that any of the parties to the demerger will enter into or carry out the scheme to obtain a tax benefit in the form of a demerger benefit or a capital benefit.

54. It is apparent that the demerger benefit and capital benefit to be provided to the Aviva shareholders will reflect the circumstances of the demerger. In this regard, it is considered that the attribution of the demerger benefit to capital is reasonable. Also, the capital benefit provided cannot be said to be attributable to the profits of the company, nor does Aviva's pattern of distributions indicate that it is being paid in substitution for a dividend. Furthermore, although the tax result for participating shareholders will be favourable, there is nothing known of the circumstances of the Aviva shareholders to indicate that the demerger will be structured to provide tax benefits. Accordingly, in this case the relevant circumstances outlined in paragraphs 45B(8)(c) to (g) of the ITAA 1936 do not incline for or against the relevant conclusion as to purpose.

## **Detailed contents list**

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**Commissioner of Taxation**

6 April 2005

<i>Previous draft:</i>	- ITAA 1936 45B(2)(c)
Not previously issued as a draft	- ITAA 1936 45B(3)(a)
	- ITAA 1936 45B(3)(b)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(4)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 45B(5)
TR 97/16; TR 2003/8	- ITAA 1936 45B(6)
	- ITAA 1936 45B(8)
<i>Subject references:</i>	- ITAA 1936 45B(8)(c)
- capital benefit	- ITAA 1936 45B(8)(d)
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- cost base adjustments	- ITAA 1936 45B(8)(f)
- demerger allocation	- ITAA 1936 45B(8)(g)
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- demerger dividend	- ITAA 1936 45C
- demerger group	- ITAA 1997 104-135
- demerger subsidiary	- ITAA 1997 109-10
- return of capital	- ITAA 1997 Div 115
- roll-over	- ITAA 1997 115-25(1)
- schemes to provide certain	- ITAA 1997 115-30(1)
benefits	- ITAA 1997 Div 125
	- ITAA 1997 125-55(1)
	- ITAA 1997 125-65(1)
<i>Legislative references:</i>	- ITAA 1997 125-65(3)
- ITAA 1936 6(1)	- ITAA 1997 125-65(4)
- ITAA 1936 6D	- ITAA 1997 125-65(6)
- ITAA 1936 44	- ITAA 1997 125-70
- ITAA 1936 44(1)	- ITAA 1997 125-70(1)
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- ITAA 1936 44(5)	- ITAA 1997 125-70(1)(d)
- ITAA 1936 45B	- ITAA 1997 125-70(1)(e)(i)
- ITAA 1936 45B(2)(a)	- ITAA 1997 125-70(1)(f)
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- ITAA 1997 125-70(2)
  - ITAA 1997 125-70(2)(a)
  - ITAA 1997 125-70(2)(b)
  - ITAA 1997 125-70(3)
  - ITAA 1997 125-70(4)
  - ITAA 1997 125-70(5)
  - ITAA 1997 125-75
  - ITAA 1997 125-75(4)
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  - ITAA 1997 125-80
  - ITAA 1997 125-80(1)
  - ITAA 1997 125-80(2)
  - ITAA 1997 125-80(3)
  - ITAA 1997 125-80(6)
  - ITAA 1997 125-85(1)
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  - Copyright Act 1968
  - TAA 1953 Pt IVAAA
  - TAA 1953 14ZAAF
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## ATO references

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