


CR 2008/90 - Income tax: demerger of Iron Road Limited by Adelaide Resources Limited

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Class Ruling

Income tax: demerger of Iron Road Limited by Adelaide Resources Limited

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant 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 45B of the ITAA 1936;
- section 45BA of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 128B of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 115-30 of the ITAA 1997;
- Division 125 of the ITAA 1997;

- Division 855 of the ITAA 1997;
- section 104-165 of the *Income Tax (Transitional Provisions) Act 1997*.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Adelaide Resources Limited (Adelaide Resources) who:

- participated in the scheme that is the subject of this Ruling; and
- owned ordinary shares in Adelaide Resources and held those on capital account at the time of the demerger.

In this Ruling, a person belonging to this class of entities is referred to as an 'Adelaide Resources 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 35 of this Ruling.

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

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

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Date of effect

8. This Ruling applies from 1 July 2008 to 30 June 2009. The Ruling continues to apply after 30 June 2009 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 settlement of a dispute agreed to before the date of issue of the 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 Deloitte Touche Tohmatsu Ltd (the applicant for this Ruling). These documents include the following:

- Class Ruling application dated 22 April 2008; and
- a letter dated 10 July 2008 from the applicant.

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

Background

10. The scheme that is the subject of this Ruling involves the demerger by Adelaide Resources of Iron Road Limited (Iron Road).

Adelaide Resources

11. At the time of this scheme, Adelaide Resources was an Australian resident company listed on the Australian Securities Exchange (ASX).

12. Adelaide Resources is a mineral exploration company that focuses on gold, copper, uranium and mineral sand deposits.

13. Before the demerger, Adelaide Resources had 83,156,035 ordinary shares on issue. It also had approximately 4,225,000 options on issue comprising:

- 3,300,000 options issued to Directors; and
- 925,000 options issued to employees.

14. The options issued to Directors represented less than 10% of all ownership interests in Adelaide Resources. As a consequence of the demerger the price at which these options could be exercised was reduced.

15. At the time of the demerger, the options issued to employees were qualifying rights within the meaning of section 139CD of the ITAA 1936 and represented less than 3% of all ownership interests in Adelaide Resources.

16. There were no other ownership interests in Adelaide Resources just before the demerger.

17. Adelaide Exploration Limited was the owner of a tenement sold to Iron Road. Prior to the demerger Adelaide Exploration Limited sold a tenement in consideration for 21,000,000 shares in Iron Road. No profit was recognised by Adelaide Resources as a result of this transaction.

18. No foreign resident Adelaide Resources shareholder (either alone or together with their associates) held 10% or more of the direct participation interests (as that term is defined in section 960-190 of the ITAA 1997) in Adelaide Resources either at the time of the demerger or for a continuous period of at least 12 months in the 24 months immediately preceding the demerger.

Iron Road

19. Iron Road was, at the time of the demerger, an Australian resident company listed on the ASX. Iron Road undertakes exploration and development of iron ore.

20. Just before the demerger, Iron Road had 54,650,000 ordinary shares and 27,325,017 options on issue. Adelaide Resources owned 21,000,000 shares and 10,500,000 options in Iron Road, which represented approximately 39% of Iron Road's issued shares and options. The book value of these shares and options in the accounts of Adelaide Resources was \$416,835.

Pre-demerger transactions

21. Before the demerger, Adelaide sold a tenement to Iron Road (refer paragraph 17 of this Ruling).

22. Iron Road then undertook an Initial Public Offer (IPO) on 28 April 2008 to raise monies to fund the advancement of its iron ore development business. Under the IPO, Iron Road issued 25,000,000 shares at 20 cents, raising a total of \$5,000,000.

23. Iron Road listed on the ASX, first trading on 12 June 2008.

The demerger

24. Adelaide Resources shareholders passed a resolution approving a capital reduction of \$311,835 (or \$0.00375 per Adelaide Resources share) that was satisfied by the *in specie* distribution of 20,789,010 Iron Road shares held by Adelaide Resources. Adelaide Resources retained 210,990 shares.

25. Adelaide Resources shareholders passed a further resolution approving a further capital reduction of \$105,000 (or \$0.001262 per Adelaide Resources share) that was satisfied by the *in specie* distribution of 10,394,505 Iron Road options held by Adelaide Resources. Adelaide Resources retained 105,495 options.

26. The total capital reduction was \$416,835 (or \$0.005012 per Adelaide Resources share – the capital reduction amount).

27. Adelaide Resources' shareholders therefore received 1 Iron Road share for every 4 Adelaide Resources shares held and 1 Iron Road option for every 8 Adelaide Resources shares held (with fractions rounded up to the nearest whole number in both cases).

28. Just after the demerger, no foreign resident shareholder of Adelaide Resources held 10% or more of the direct participation interests in Iron Road.

Accounting for the demerger

29. Adelaide Resources accounted for the demerger as follows:

Dr	Share capital	\$416,835	
	Cr	Investment in Iron Road	\$416,835

30. The capital reduction amount reflects the share capital of Adelaide Resources that was applied to the Iron Road investment. The applicant advises that the market value of Adelaide Resources' investment in Iron Road at the time of the demerger exceeded the capital reduction amount.

Reasons for the demerger

31. The applicant advises that the demerger was undertaken to allow Adelaide Resources and Iron Road to conduct their business undertakings independently. The demerger will allow each company to pursue focused strategies that are consistent with its strengths and capabilities in the particular field in which it operates.

Other matters

32. No Adelaide Resources shareholder acquired their shares in Adelaide Resources before 20 September 1985.

33. Adelaide Resources confirms that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997, from any of its other accounts and accordingly, its share capital account is not tainted (within the meaning in Division 197 of the ITAA 1997).

34. Just after the demerger, at least 50% of the market value of capital gains tax (CGT) assets owned by Iron Road or a demerger subsidiary (as defined in section 125-65 of the ITAA 1997) were used in the carrying on of a business.

35. Adelaide Resources did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and 44(4) of the ITAA 1936 not apply to any demerger dividend paid under this scheme.

Ruling

CGT event G1

36. CGT event G1 happened in relation to each share owned by Adelaide Resources shareholders at the time Adelaide Resources made the payment of the capital reduction amount (section 104-135 of the ITAA 1997).

37. An Adelaide Resources shareholder made a capital gain under CGT event G1 if the capital reduction amount exceeded the cost base of the Adelaide Resources share. The capital gain is equal to the amount of the excess (subsection 104-135(3) of the ITAA 1997).

(A) CGT consequences for Australian residents

38. The following CGT consequences apply to an Adelaide Resources shareholder who was a resident of Australia (as that term is defined in subsection 6(1) of the ITAA 1936) at the time of the demerger.

Demerger roll-over relief

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

40. An Adelaide Resources shareholder can choose demerger roll-over under subsection 125-55(1) of the ITAA 1997 for their Adelaide Resources shares.

CGT consequences of choosing roll-over

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

Other consequences of choosing roll-over

42. If an Adelaide Resources shareholder chooses roll-over relief, they must also recalculate the cost base and reduced cost base of their Adelaide Resources shares, Iron Road shares and Iron Road options.

43. The first element of the cost base and reduced cost base of each Adelaide Resources share and corresponding Iron Road shares and Iron Road options received under the demerger is worked out as follows:

- sum the cost bases of the Adelaide Resources shares (just before the demerger); and
- apportion that total over the remaining Adelaide Resources shares and corresponding new Iron Road shares and Iron Road options received under the demerger.

The apportionment of this total is done on a reasonable basis having regard to the market values (just after the demerger) of the Adelaide Resources shares, Iron Road shares and Iron Road options, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

44. The Commissioner accepts that a reasonable apportionment of the total cost base is to:

- attribute 53% of the total cost base to the Adelaide Resources shares;
- attribute 42% of the total cost base to the Iron Road shares; and
- attribute 5% of the total cost base to the Iron Road options.

Adelaide Resources shareholders who do not choose demerger roll-over

45. An Adelaide Resources shareholder who does not choose demerger roll-over will not disregard any capital gain made when CGT event G1 happened to their Adelaide Resources share under the demerger.

46. The first element of the cost base and reduced cost base of each Adelaide Resources share and corresponding Iron Road shares and Iron Road options is calculated in the manner described in paragraph 43 of this Ruling (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of the Iron Road shares and Iron Road options for the purposes of the CGT discount

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

(B) CGT consequences for foreign residents

48. At the time of the demerger, no Adelaide Resources shareholder held an interest in Adelaide Resources that passed the non-portfolio interest test (section 960-195 of the ITAA 1997). It follows that no Adelaide Resources shareholder held shares in Adelaide Resources that were taxable Australian property (TAP), except for those foreign resident individuals who:

- (a) were Australian residents when they acquired their Adelaide Resources shares;
- (b) stopped being Australian residents while holding their Adelaide Resources shares; and
- (c) chose, under subsection 104-165(2) of the ITAA 1997 to disregard a capital gain or capital loss from CGT event I1 (section 104-160 of the ITAA 1997) in relation to their Adelaide Resources shares (subsection 104-165(3) of the ITAA 1997, subsections 104-165(1) and 104-165(2) of the *Income Tax (Transitional Provisions) Act 1997*).

Foreign residents whose shares in Adelaide Resources were not TAP

49. A foreign resident Adelaide Resources shareholder whose shares in Adelaide Resources were not TAP will disregard any capital gain made when CGT event G1 happened under the demerger (section 855-10 of the ITAA 1997).

Foreign residents whose shares in Adelaide Resources were TAP

50. A foreign resident Adelaide Resources shareholder whose shares in Adelaide Resources were TAP cannot disregard, under section 855-10 of the ITAA 1997, any capital gain made when CGT event G1 happened under the demerger.

Foreign residents cannot choose demerger roll-over

51. A foreign resident Adelaide Resources shareholder cannot choose demerger roll-over to disregard any capital gain made when CGT event G1 happened under the demerger as, just after the demerger, there were no non-portfolio interests in Iron Road (subsection 125-55(2) and section 960-195 of the ITAA 1997).

Cost base of the Adelaide Resources shares, Iron Road shares and Iron Road options

52. The first element of the cost base and reduced cost base of each Adelaide Resources share and corresponding Iron Road shares and Iron Road options is calculated in the manner described in paragraph 43 of this Ruling (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of the Iron Road shares and Iron Road options for the purposes of the CGT discount

53. For the purpose of determining eligibility to a discount capital gain, the Iron Road shares and Iron Road options received by a foreign resident Adelaide Resources shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding Adelaide Resources shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This will be the case even if the foreign resident Adelaide Resources shareholder cannot choose roll-over.

(C) Dividend consequences***Demerger dividend***

54. Any dividend arising under the demerger will be a demerger dividend (subsection 6(1) of the ITAA 1936).

55. The demerger dividend will be neither assessable income nor exempt income of the participating Adelaide Resources shareholders (subsections 44(3) and 44(4) of the ITAA 1936). The demerger dividend is not subject to withholding tax under section 128B of the ITAA 1936 (subsection 128B(3D) of the ITAA 1936).

56. As the capital reduction amount will be debited to Adelaide Resources' share capital account it will not be a dividend, as defined in subsection 6(1) of the ITAA 1936 (see the exclusion contained in paragraph (d) of the definition of a dividend in subsection 6(1) of the ITAA 1936).

Application of sections 45B, 45BA and 45C

57. 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 participating Adelaide Resources' shareholders under the demerger.

58. 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 participating Adelaide Resources' shareholders under the demerger.

Commissioner of Taxation

17 December 2008

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.*

59. The significant tax consequences of the scheme are the availability of demerger roll-over under Division 125 of the ITAA 1997 and the demerger dividend concession in section 44 and subsection 128B(3D) of the ITAA 1936. Broadly, they enable Adelaide Resources shareholders (other than those whose Adelaide Resources shares were TAP) to disregard a capital gain made under a demerger and ensure the demerger dividend is non assessable non exempt income and not subject to withholding tax. They also provide special rules for calculating the cost base and reduced cost base of the Adelaide Resources shares, Iron Road shares and Iron Road options.

Conditions for demerger roll-over relief

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

- (a) a shareholder 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; and
- (d) under the demerger, a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity.

61. Under the scheme the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 were satisfied. As a consequence the demerger concessions are available to the resident Adelaide Resources shareholders.

Demerger dividend

62. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income a dividend, 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 a resident of Australia) and from an Australian source (if the shareholder is a foreign resident).

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

64. The definition of 'share capital account' in section 975-300 of the ITAA 1997 is 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.

65. 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.

66. In the circumstances of this demerger, the amount that Adelaide Resources debits to its share capital account will not constitute a dividend for the purposes of subsection 6(1) of the ITAA 1936 and will not be assessable as a dividend under subsection 44(1) of the ITAA 1936.

67. However, if the value of Iron Road shares and Iron Road options distributed under the demerger exceeds the amount debited against Adelaide Resources' share capital account, a dividend will arise for participating Adelaide Resources shareholders (as per Taxation Ruling TR 2003/8). However, subject to the integrity rules in section 45B of the ITAA 1936, this dividend will constitute non-assessable, non-exempt income in the hands of Adelaide Resources shareholders as the following criteria are met:

- the dividend amount is a *demerger dividend* (as defined in subsection 6(1) of the ITAA 1936);
- Adelaide Resources 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.

68. The demerger dividend is not subject to withholding tax when paid to a foreign resident (subsection 128B(3D) of the ITAA 1936).

Anti-avoidance provision – section 45B

69. 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 (subsection 45B(1) of the ITAA 1936).

70. 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 participating Adelaide Resources' shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

71. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(a) or paragraph 45B(3)(b) of the ITAA 1936 that either section 45BA or section 45C of the ITAA 1936 applies to the scheme to which this Ruling relates.

72. Consequently, participating Adelaide Resources' shareholders can choose CGT demerger roll-over relief and are subject to the dividend concessions as outlined in detail in the Ruling part of this document and no further explanation beyond that contained in the Ruling part of this document is necessary.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- capital benefit
- capital gains
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary

Legislative references:

- | | |
|--|--|
| <ul style="list-style-type: none">- ITAA 1936 6(1)- ITAA 1936 44- ITAA 1936 44(1)- ITAA 1936 44(2)- ITAA 1936 44(3)- ITAA 1936 44(4)- ITAA 1936 44(5)- ITAA 1936 45B- ITAA 1936 45B(1)- 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 1936 128B | <ul style="list-style-type: none">- ITAA 1936 128B(3D)- ITAA 1936 139CD- ITAA 1997 104-135- ITAA 1997 104-135(3)- ITAA 1997 104-160- ITAA 1997 104-165(2)- ITAA 1997 104-165(3)- ITAA 1997 115-30- ITAA 1997 115-30(1)- ITAA 1997 Div 125- ITAA 1997 125-55(1)- ITAA 1997 125-55(2)- ITAA 1997 125-65- 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 197- ITAA 1997 Div 855- ITAA 1997 855-10- ITAA 1997 960-190- ITAA 1997 960-195- ITAA 1997 975-300- ITAA 1997 975-300(3)- Income Tax (Transitional Provisions) Act 1997 104-165- Income Tax (Transitional Provisions) Act 1997 104-165(1)- Income Tax (Transitional Provisions) Act 1997 104-165(2)- TAA 1953- Copyright Act 1968 |
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ATO references

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