


CR 2010/78 - Income tax: demerger of Teranga Gold Corporation Limited by Mineral Deposits Limited

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Class Ruling

Income tax: demerger of Teranga Gold Corporation Limited by Mineral Deposits Limited

LEGALLY BINDING

SECTION:

Class Ruling

What this Ruling is about 2

Relevant provision(s) 2

Page 2 of 19

Class of entities 3 Page status: **legally binding**

Qualifications 3

Date of effect 4

Scheme 4

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

Background 4

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

Relevant entities 5

MDL 5

Teranga 5

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.

Pre demerger transactions 5

The demerger of *Teranga* 6

Listing and IPO 6

Share consolidation of MDL 6

Shares 6

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.

Reasons for the demerger 7

Other matters 7

Ruling 8

CGT event G1 8

CGT consequences for Australian residents 8

Demerger roll-over 8

CGT consequences of choosing roll-over 8

Other consequences of choosing roll-over 9

MDL shareholders who do not choose demerger roll-over 9

Acquisition date of the Teranga shares for the purposes of the CGT discount 10

CGT consequences for foreign residents 10

Foreign residents cannot choose demerger roll-over 10

Foreign residents whose shares in MDL were not TAP 10

Foreign residents whose shares in MDL were TAP 10

All foreign residents—Cost base of the MDL shares and Teranga shares 11

All foreign residents—Acquisition date of the Teranga shares for the purposes of the CGT discount 11

Dividend Consequences 11

Demerger dividend 11

Application of sections 45B, 45BA and 45C 11

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 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 104-160 of the ITAA 1997;
- section 104-165 of the ITAA 1997;
- section 115-30 of the ITAA 1997;
- Division 125 of the ITAA 1997;
- Division 855 of the ITAA 1997; and
- section 960-195 of the ITAA 1997.

All subsequent 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 are the holders of ordinary shares in Mineral Deposits Limited (MDL) who:

- (a) were listed on the share register of MDL as at 1 December 2010 (the Record Date for the demerger of shares in Teranga Gold Corporation Limited (Teranga));
- (b) held their MDL shares on capital account on that date; and
- (c) were not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their MDL shares.

(Note: Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them).

4. In this ruling, a person belonging to this class of entities is referred to as an 'MDL shareholder'.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. 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 10 to 34 of this Ruling.

7. 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

9. This Ruling applies from 1 July 2010 to 30 June 2011. The Ruling continues to apply after 30 June 2011 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

10. The following description of the Scheme is based on information provided by the applicant.

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

Background

11. On 3 December 2010, MDL affected a demerger of 80% of the shares in its wholly owned subsidiary, Teranga. The demerger formed the central component of a restructuring of the MDL Group that was announced by the MDL Board on 23 August 2010.

Relevant entities***MDL***

12. MDL is an Australian resident company listed on the Australian Securities Exchange (ASX). MDL is a 'listed public company' (as that term is defined in subsection 995-1(1)) and is the head company of the MDL tax consolidated group (under Part 3-90).

13. The MDL tax consolidated group includes the following wholly owned Australian resident entities:

- MDL (Gold) Limited (MDL Gold); and
- MDL (Mining) Limited.

14. Prior to the demerger, the MDL Group conducted two core businesses principally in Africa:

- a gold mining business operated by entities – Sabodala Gold (Mauritius) Limited (Sabodala) and SGML (Capital) Limited (SGML) – controlled by MDL Gold; and
- a mineral sands business operated by entities controlled by MDL (Mining) Limited.

15. As at 28 September 2010, MDL had 606,441,673 ordinary shares on issue, of which approximately 62% were owned by foreign resident shareholders. MDL also had 30,700,000 units of unlisted options of various types on issue. All of the options on issue included a clause which ensured that, in the event of a return of capital by MDL, the exercise price would be reduced by the amount of capital returned in relation to each MDL security.

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

Teranga

17. Teranga was incorporated in Canada. Its share capital initially comprised 100 ordinary shares all of which were owned by MDL.

Pre demerger transactions

18. Prior to the demerger, MDL and MDL Gold undertook certain transactions to facilitate the demerger including:

- the incorporation of Teranga as a limited liability company registered in Canada wholly owned by MDL;
- the transfer by MDL Gold of:
 - all of its equity in Sabodala, SGML and Oromin Explorations Limited (being a 15% interest) to Teranga; and

- a receivable owed by Sabodala Gold Operations SA of USD234,300,000 to a wholly owned subsidiary of Teranga.
in consideration for the issue of 200,000,000 ordinary Teranga shares and deferred cash consideration of CAD50,000,000 payable by Teranga to MDL Gold.
- the transfer by MDL Gold of its 200,000,000 shares in Teranga to MDL.

The demerger of Teranga

19. The demerger of Teranga was undertaken pursuant to a vote of shareholders at the Special and Annual General Meeting held on 9 November 2010. At the Special and Annual General Meeting, shareholders approved an ordinary resolution to reduce the issued share capital of MDL, without redeeming or cancelling any shares, by the amount of USD188,554,766.

20. The capital reduction was satisfied by an *in specie* distribution of 80% of the Teranga shares held by MDL. MDL's shareholders received Teranga shares on a proportionate and approximate basis of 1 Teranga share for every 3.79 MDL shares held at the Record Date.

21. The holder of options in MDL did not receive shares or options in Teranga under the demerger. However, the exercise price of each option was adjusted to reflect the capital return.

22. MDL accounted for the capital reduction and *in specie* distribution as follows:

DR Share Capital	USD188,554,766
CR Investment in Teranga	USD188,554,766

23. The *in specie* distribution was undertaken on the basis that its aggregate money value would exceed the amount debited to MDL's share capital.

Listing and IPO

24. Teranga intends to conduct an initial public offering (IPO) in Canada involving the offer of new Teranga shares to investors.

25. No existing MDL shareholder will receive a priority right to invest in Teranga via the IPO.

Share consolidation of MDL Shares

26. At the Special and Annual Meeting of 9 November 2010, MDL shareholders voted in favour of a resolution for MDL to convert its shares into the smaller number of shares derived by multiplying the total number of shares in MDL on issue as at 1 December 2010 by

10% (fractions of shares being rounded down to the nearest whole share).

Reasons for the demerger

27. MDL expects that a number of advantages will accrue to its shareholders as a result of the separation of the gold business and the mineral sands business. The demerger is expected to:

- provide MDL shareholders with greater flexibility in respect of their investment portfolio by enabling them separately to determine their exposure to their gold and mineral sands businesses;
- allow for a better focus on the development and mining of the Sabodala gold operation through a separate listing of Teranga, whilst MDL continues to develop the separate and distinct mineral sands project;
- ensure that the ability of MDL to further develop the mineral sands project to the extent considered necessary or desirable by the directors is not diminished by having resources focused on the Sabodala gold operations;
- allow the ability to raise capital for the gold business by way of an IPO of Teranga on the Toronto Stock Exchange (TSX);
- separate the gold and mineral sands business so that each business can pursue its own focus without being adversely impacted by the other business; and
- allow a new board (appointed to Teranga) to manage the gold business, with specific industry experience and skills required to manage and grow the gold business successfully.

Other matters

28. None of the MDL shareholders acquired their shares in MDL before 20 September 1985.

29. MDL has confirmed that there has been no transfer to its share capital account, as defined in section 975-300, from any of its other accounts. Accordingly its share capital account is not tainted within the meaning of Division 197.

30. MDL will not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) not apply to the demerger dividend.

31. Just after the demerger, at least 50% of the market value of capital gains tax (CGT) assets owned by Teranga or its demerger subsidiaries were used in the carrying on of a business by those entities.

32. Less than 50% (by market value) of the underlying assets of MDL consist of real property interests (including mining rights) situated in Australia. Consequently, for income tax purposes, the MDL shares would not be 'taxable Australian property' (section 855-10).

33. Less than 50% (by market value) of the underlying assets of Teranga consist of real property interests (including mining rights) situated in Australia. Consequently, for income tax purposes, the Teranga shares would not be 'taxable Australian property' (section 855-10).

34. There was also no off-market buy-back of shares under this arrangement or circumstances where MDL shareholders could obtain roll-over under another provision of the ITAA 1997.

Ruling

CGT event G1

35. CGT event G1 happened in relation to each of the MDL ordinary shares owned by the MDL shareholders at the time of the capital reduction (section 104-135).

36. MDL shareholders made a capital gain under CGT event G1 if the capital reduction amount exceeded the cost base of the MDL 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)).

CGT consequences for Australian residents

37. The following CGT consequences apply to an MDL 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

38. MDL and its subsidiary Teranga are part of a demerger group under subsection 125-65(1).

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

40. MDL shareholders can choose demerger roll-over under subsection 125-55(1) for their MDL shares.

CGT consequences of choosing roll-over

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

Other consequences of choosing roll-over

42. An MDL shareholder who chooses roll-over for their MDL shares is required to recalculate the cost base and reduced cost base of their MDL and Teranga shares.

43. The first element of the cost base and reduced cost base of each MDL share and corresponding Teranga shares received under the demerger is worked out as follows:

- take the sum of the cost bases of the MDL shares (just before the demerger); and
- apportion that sum over the MDL shares and corresponding new Teranga shares received under the demerger.

44. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the MDL and Teranga shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3)).

45. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3), the Commissioner accepts the volume weighted average price of the MDL shares, as traded on the ASX (whether on a deferred or normal settlement basis), and Teranga shares, as traded on the TSX (whether on a deferred or normal settlement basis) over its first five trading days as a reasonable approximation of the relative market value of those shares.

Note: the market values of Teranga and MDL based on five day volume average weighted prices will be advised by MDL shortly after the listing of Teranga on the TSX.

MDL shareholders who do not choose demerger roll-over

46. An MDL shareholder who does not choose demerger roll-over:

- is not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their MDL shares under the demerger; and
- the first element of the cost base and reduced cost base of each MDL share and corresponding Teranga share is calculated in the manner described in paragraph 43 of this Ruling (subsections 125-85(1) and 125-85(2)).

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

47. For the purposes of determining eligibility for a discount capital gain, the Teranga shares received by an MDL shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding MDL shares (item 2 in the table in subsection 115-30(1)). This will be the case irrespective of whether or not demerger roll-over is chosen.

CGT consequences for foreign residents

48. At the time of the demerger, MDL's underlying value was not principally derived from Australian real property (section 855-30). It follows that no MDL shareholder held shares in MDL that were taxable Australian property (TAP), except for those foreign resident individuals who:

- (a) were Australian residents when they acquired their MDL shares;
- (b) stopped being Australian residents while holding their MDL shares; and
- (c) chose, under subsection 104-165(2) to disregard a capital gain or capital loss from CGT event I1 (section 104-160) in relation to their MDL 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 cannot choose demerger roll-over

49. A foreign resident MDL shareholder cannot choose demerger roll-over to disregard any capital gain made when CGT event G1 happened under the demerger because each Teranga share it acquired under the demerger was not taxable Australian property just after they acquired it (subsection 125-55(2) and section 960-195).

Foreign residents whose shares in MDL were not TAP

50. A foreign resident MDL shareholder whose shares in MDL were not TAP shall disregard any capital gain made when CGT event G1 happened under the demerger (section 855-10).

Foreign residents whose shares in MDL were TAP

51. A foreign resident MDL shareholder whose shares in MDL were TAP cannot disregard, under section 855-10, any capital gain made when CGT event G1 happened under the demerger.

All foreign residents—Cost base of the MDL shares and Teranga shares

52. The first element of the cost base and reduced cost base of each MDL share and corresponding Teranga shares is calculated in the manner described in paragraph 43 of this Ruling (subsections 125-85(1) and 125-85(2)).

All foreign residents—Acquisition date of the Teranga shares for the purposes of the CGT discount

53. For the purposes of determining eligibility for a discount capital gain, the Teranga shares received by a foreign resident MDL shareholder are taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding MDL share (item 2 in the table in subsection 115-30(1)).

Dividend Consequences***Demerger dividend***

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

55. MDL shareholders received a demerger dividend in the amount of a pro rata share of the excess of the money value of the *in specie* distribution over the amount debited to MDL's share capital account (see Taxation Ruling TR 2008/3).

56. The demerger dividend is neither assessable income nor exempt income of the MDL shareholders (subsections 44(3) and 44(4) of the ITAA 1936).

57. The demerger dividend is not subject to dividend withholding tax under section 128B of the ITAA 1936 (subsection 128B(3D) of the ITAA 1936).

Application of sections 45B, 45BA and 45C

58. 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 a MDL shareholder under the demerger.

59. The Commissioner will not make a determination under paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole or any part of the capital benefit provided to an MDL shareholder under the demerger.

Appendix 1 – Explanation

ⓘ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

CGT consequences

60. The CGT consequences and relevant legislative provisions that arise concerning the scheme that is the subject of this Ruling are outlined in the Ruling part of this document.

61. A significant tax consequence of the Scheme is the availability of demerger roll-over relief under Division 125. Broadly, resident MDL shareholders can choose roll-over to disregard a capital gain made under the demerger. A foreign resident shareholder cannot choose roll-over.

62. There are special rules for calculating the cost base and reduced cost base of the MDL and Teranga shares for MDL shareholders whether or not they choose roll-over.

Conditions for demerger roll-over

63. The conditions for roll-over under Division 125 are satisfied in the current scheme. The Ruling section provides a detailed explanation of the Commissioner's decision. Therefore, no further explanation is warranted other than in one aspect of the conditions for roll-over. The relevant issue concerns the treatment of 'adjusting instruments' in determining whether a demerger happens to a demerger group. This matter is explained at paragraph 64 of this Ruling.

Adjusting instruments

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

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

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

66. The MDL options represent significantly less than 10% of the ownership interest in the company. They account for 4.74 % by number and approximately 0.137 % by value of MDL's ownership interests. Further, the options are issued on terms that, in accordance with ASX Listing Rules, the exercise price will be reduced by the amount of capital component of a demerger allocation. For these reasons, it is considered that the MDL options can be disregarded for the purposes of the proportion test.

Demerger dividend

67. Subsection 44(1) of the ITAA 1936 operates to include in a shareholder's assessable income any dividends, within the meaning of that term in subsection 6(1) of the ITAA 1936, paid to a shareholder out of company profits.

68. Paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 provides that a dividend excludes amounts debited against an amount standing to the credit of the share capital account of the company.

69. 'Share capital account' is defined in section 975-300 as an account that the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

70. However, subsection 975-300(3) 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 applies is transferred to the share capital account where the account is not already tainted.

71. In the circumstances of this demerger, MDL will debit an amount of USD188,554,766 to its 'share capital account' (as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300 of the ITAA 1997). This amount will therefore not be 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.

72. However, MDL shareholders did receive a dividend to the extent that the market value of the Teranga shares distributed under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

73. This dividend is neither assessable income nor exempt income (subsections 44(3) and 44(4) of the ITAA 1936) if:

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

74. In the present circumstances, as each of the conditions in paragraph 73 of this Ruling are satisfied, the dividend received by MDL shareholders under the demerger will be neither assessable income nor exempt income by operation of subsections 44(3) and 44(4) of the ITAA 1936.

Non-resident shareholders—Dividend withholding tax

75. The MDL demerger dividend is not subject to withholding tax under section 128B of the ITAA 1936 (subsection 128B(3D) of the ITAA 1936).

The application of sections 45B, 45BA and 45C

76. Section 45B of the ITAA 1936 applies to ensure that relevant amounts are treated as dividends for taxation purposes if:

- components of a demerger allocation as between capital and profit do not reflect the circumstances of the demerger; or
- certain payments, allocations and distributions are made in substitution for dividends (subsection 45B(1) of the ITAA 1936).

77. Specifically, the provision applies where:

- (a) 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);
- (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 the scheme 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).

78. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, subsection 45B(3) of the ITAA 1936 empowers the Commissioner to make a determination that either section 45BA of the ITAA 1936 applies in relation to a demerger benefit or section 45C of the ITAA 1936 applies in relation to a capital benefit.

79. The arrangement involving the *in specie* distribution to MDL shareholders of Teranga shares constitutes a scheme for the purposes of section 45B of the ITAA 1936.

80. The provision of ownership interests to a shareholder under a demerger constitutes the shareholder being provided with a demerger benefit (subsection 45B(4) of the ITAA 1936) and a capital benefit (subsection 45B(5) of the ITAA 1936) to the extent that the demerger benefit is not a demerger dividend (subsection 45B(6) of the ITAA 1936).

81. Under the present scheme, the provision of the Teranga shares will constitute the participating MDL shareholders receiving a demerger benefit and a capital benefit.

82. 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 (participating shareholders) to obtain a tax benefit. On the basis of the information surrounding the *in specie* distribution of Teranga shares as described in the Ruling application and further information, the Commissioner has formed the view that the demerger and capital benefits provided to the MDL shareholders have not been made for a more than incidental purpose of obtaining a tax benefit.

83. Accordingly, the Commissioner will not make a determination under paragraphs 45B(3)(a) or 45B(3)(b) of the ITAA 1936, that either sections 45BA or 45C of the ITAA 1936 apply to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	5
Date of effect	9
Scheme	10
Background	11
Relevant entities	12
<i>MDL</i>	12
<i>Teranga</i>	17
Pre demerger transactions	18
The demerger of Teranga	19
Listing and IPO	24
Share consolidation of MDL shares	26
Reasons for the demerger	27
Other matters	28
Ruling	35
CGT event G1	35
CGT consequences for Australian residents	37
<i>Demerger roll-over</i>	38
<i>CGT consequences of choosing roll-over</i>	41
<i>Other consequences of choosing roll-over</i>	42
<i>MDL shareholders who do not choose demerger roll-over</i>	46
<i>Acquisition date of the Teranga shares for the purpose of the CGT discount</i>	47
CGT Consequences for foreign residents	48
<i>Foreign residents cannot choose demerger roll-over</i>	49
<i>Foreign residents whose shares in MDL were not TAP</i>	50
<i>Foreign residents whose shares in MDL were TAP</i>	51
<i>All foreign residents-Cost base of the MDL and Teranga shares</i>	52
<i>All foreign residents-Acquisition date of the Teranga shares for the purpose of the CGT discount</i>	53

Dividend consequences	54
<i>Demerger dividend</i>	54
Application of sections 45B, 45BA and 45C	58
Appendix 1 – Explanation	60
CGT consequences	60
Conditions for demerger roll-over	63
<i>Adjusting instruments</i>	64
Demerger dividend	67
Non-resident shareholders – dividend withholding tax	75
Application of sections 45B, 45BA and 45C	76
Appendix 2 – Detailed contents list	84

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- capital benefits
- capital gains
- capital proceeds
- CGT event G1 – G3 – shares
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger group
- demerger subsidiary
- return of capital on shares

Legislative references:

- ITAA 1936 6(1)
 - 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)
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(4)
 - ITAA 1936 45B(5)
 - ITAA 1936 45B(6)
 - ITAA 1936 45B(8)
 - ITAA 1936 45B(9)
 - ITAA 1936 45B(10)
 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1936 47
 - ITAA 1936 128B(3D)
 - ITAA 1936 177D(b)
 - ITAA 1997 104-135
 - ITAA 1997 104-135(1)
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-160
 - ITAA 1997 104-165(1)
 - ITAA 1997 104-165(2)
 - ITAA 1994 104-165(3)
 - ITAA 1997 109-10
 - ITAA 1997 110-25
 - ITAA 1997 115-25(1)
 - ITAA 1997 115-30
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-55(2)
 - ITAA 1997 125-60(1)
 - ITAA 1997 125-65(1)
 - ITAA 1997 125-65(3)
 - ITAA 1997 125-65(4)
 - ITAA 1997 125-65(6)
 - ITAA 1997 125-70
 - ITAA 1997 125-70(1)
 - ITAA 1997 125-70(1)(a)
 - ITAA 1997 125-70(1)(b)(i)
 - ITAA 1997 125-70(1)(c)(i)
 - ITAA 1997 125-70(1)(d)
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