


CR 2011/28 - Income tax: demerger of Straits Metals Limited by Straits Resources Limited

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Class Ruling

Income tax: demerger of Straits Metals Limited by Straits Resources Limited

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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.

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 45 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;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- subsection 115-30(1) of the ITAA 1997; and
- Division 125 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the holders of shares in Straits Resources Limited (SRL) who:

- (a) were listed on the share register of SRL as at the Demerger Record Date (Record Date);
- (b) held their SRL shares on capital account on the Record Date;
- (c) were a 'resident of Australia' as defined in subsection 6(1) of the ITAA 1936 on the Record Date; and
- (d) were not subject to the taxation of financial arrangement rules in Division 230 of the ITAA 1997 in relation to gains and losses on their SRL shares.

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

In this Ruling, a person belonging to this class of entities is referred to as an 'SRL 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 32 of this Ruling.

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

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- this Ruling may be withdrawn or modified.

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Date of effect

8. 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

9. 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

10. The demerger of SRL's metals business was recommended to SRL shareholders in an Australian Securities Exchange (ASX) announcement on 11 November 2010. The announcement also recommended the acquisition, following the demerger, of 100% of the shares in SRL by PTT Mining Limited (PTTML).

SRL

11. SRL is an Australian resident company incorporated in 1992 and listed on the ASX. SRL is the head company of a consolidated tax group for the purposes of Part 3-90 of the ITAA 1997.

12. SRL is a mining company which just prior to the demerger had two primary businesses, coal and metals.

13. Before the demerger, SRL held interests in resource projects with a focus on base metals, precious metals, speciality metals trading, magnesium alloy and anode production and bulk commodities.

14. As at the date of the Scheme Booklet, SRL had the following ownership interests on issue:

- 255,203,614 shares;
- 150,000 options issued under an employee share option plan; and
- 55,000,000 convertible notes issued to Standard Chartered Private Equity Limited (SCPE) which entitled SCPE to shares upon conversion.

15. On 18 January 2011 the total number of SRL shares on issue increased to 316,342,835 following conversion of the convertible notes on issue.

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

17. SRL cancelled all outstanding options on issue prior to the date of the demerger.

Pre-demerger transactions

18. Prior to the demerger, members of the SRL group of companies undertook a number of transactions to facilitate the demerger including:

- the incorporation of a new wholly owned subsidiary of SRL, Straits Metals Limited (SML); and
- an intra-group transfer of all assets of SRL's metals business to SML, which issued shares to SRL as consideration for the transfer of the metals business.

The demerger

19. On 21 January 2011, SRL shareholders voted at a general meeting to approve the Capital Reduction resolution to reduce the share capital of SRL by \$219,921,539 in total (or \$0.6952 per SRL share – capital reduction amount).

20. SRL applied the Capital Reduction entitlement of each SRL shareholder at the Record Date as consideration for the transfer of SML shares in accordance with the Demerger Scheme of Arrangement.

21. SRL shareholders received one SML share for each SRL share they held on the Record Date.

22. As a result of the demerger, SRL shareholders owned shares in both SRL and SML.

Ineligible foreign shareholders

23. SML shares were not issued to certain shareholders of SRL whose address was in a place outside Australia (ineligible foreign shareholders). These shareholders held approximately 0.05% of the shares in SRL at the time of the demerger. The SML shares that the ineligible foreign shareholders were entitled to were instead sold through a share sale facility with the net proceeds paid to the relevant SRL shareholder.

Accounting for the demerger

24. SRL accounted for the demerger as follows:

| | | | |
|----|---------------|----------------------------|---------------|
| DR | Share capital | \$219,921,539 | |
| | CR | Provision for distribution | \$219,921,539 |

25. The capital reduction amount reflects the share capital of SRL that was applied to the SML investment.

Purpose of the demerger

26. SRL's purpose in undertaking the demerger was to promote a more efficient structure for the respective metals and coal businesses. The separation of the two businesses provided greater clarity of identity to both businesses through the creation of a pure metals company and a pure coal company both listed on the ASX.

27. The separation of SRL and SML was considered desirable having regard to the differences in the businesses of those two entities. The separation of the coal business from the metals business was expected to allow improved ability and flexibility for the management teams of both SML and SRL to articulate distinct strategies for each business and to pursue suitable growth opportunities. The separation of SRL and SML will provide dedicated capital to each of the entities to execute their respective business plans.

Post demerger

28. SRL and SML were separately listed on the ASX.

29. SRL was renamed International Coal Holdings Limited.

30. SML was renamed Straits Resources Limited.

Other matters

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

32. SRL confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997 at the demerger implementation date.

Ruling

The demerger of SML

CGT event G1

33. CGT event G1 happened in relation to each of the SRL shares owned by the SRL shareholders at the time SRL made the payment of the capital reduction amount (section 104-135).

Capital gain

34. SRL shareholders made a capital gain from CGT event G1 happening if the capital reduction amount exceeded the cost base of the SRL share. The capital gain is equal to the amount of the excess. No capital loss can be made from CGT event G1 (subsection 104-135(3)).

Demerger roll-over

35. A demerger, as defined under section 125-70, happened to the SRL demerger group under the scheme.

36. An SRL shareholder can choose demerger roll-over under subsection 125-55(1) for their SRL shares.

CGT consequences of choosing roll-over

37. An SRL shareholder who chooses demerger roll-over will disregard any capital gain made when CGT event G1 happened in relation to each of their SRL shares under the demerger (subsection 125-80(1)).

Other consequences of choosing roll-over

38. An SRL shareholder who chooses demerger roll-over must also recalculate the cost base and reduced cost base of their SRL shares and calculate the cost base and reduced cost base of their new SML shares.

39. The first element of the cost base and reduced cost base of each SRL share and corresponding SML share received under the demerger is worked out as follows:

- total the cost bases of the SRL shares (just before the demerger); and
- apportion that sum over the SRL shares and corresponding new SML shares received under the demerger.

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

41. The Commissioner accepts that a reasonable apportionment of the summed cost base is to:

- attribute 71% of the summed cost base to the SRL shares; and
- attribute 29% of the summed cost base to the SML shares.

SRL shareholders who do not choose demerger roll-over

42. An SRL shareholder who does not choose demerger roll-over will not disregard any capital gain made when CGT event G1 happened in relation to an SRL share under the demerger.

43. The first element of the cost base and reduced cost base of each SRL share and corresponding SML share is calculated as described in paragraphs 39 and 41 of this Ruling (subsections 125-85(1) and (2)).

Acquisition date of SML shares for the purpose of a discount capital gain

44. For the purpose of determining eligibility for a discount capital gain, an SML share received by an SRL shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding SRL share (item 2 of the table in subsection 115-30(1)). This will be the case whether or not the SRL shareholder chooses demerger roll-over.

Dividend

45. As the capital reduction amount was debited to SRL's share capital account it is not a dividend, as defined in subsection 6(1) of the ITAA 1936.

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

46. Section 45 and section 45A of the ITAA 1936 will not apply to the whole or any part of any demerger benefit provided to SRL shareholders under the demerger.

47. 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 SRL shareholders under the demerger.

48. 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 SRL shareholders under the demerger.

Commissioner of Taxation

9 March 2011

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.*

49. The CGT consequences of the demerger of SML are described in paragraphs 33 to 44 of this Ruling.

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

- (a) a person owns a share in a company, or a unit or other interest in a trust (the original interest);
- (b) the company or trust 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 the person acquires a new or replacement interest in the demerged entity and nothing else.

51. Under the scheme, the conditions for choosing demerger roll-over under Division 125 were satisfied in respect of the demerger of SML. As a consequence, demerger relief in Division 125 is available to the SRL shareholders in respect of the demerger of SML.

Dividend

52. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends, as defined in subsection 6(1) of the ITAA 1936, paid to the shareholders out of profits derived by the company from any source if the shareholder is a resident of Australia.

53. 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.

54. In the circumstances of this demerger, SRL debited a capital reduction amount 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 is therefore not a dividend for the purposes of subsection 6(1) of the ITAA 1936 and is not assessable as a dividend under subsection 44(1) of the ITAA 1936.

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

Section 45

55. Section 45 of the ITAA 1936 applies where a company streams the provision of shares and the payment of minimally franked dividends to its shareholders in such a way that the shares are received by some shareholders and minimally franked dividends are received by other shareholders. Minimally franked dividends are dividends which are not franked or are franked to less than 10%.

56. Based on the information provided and having regard to the circumstances of the scheme, section 45 of the ITAA 1936 will not apply to the whole or any part of any demerger benefit received by SRL shareholders.

Section 45A

57. 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.

58. Where the Commissioner makes a written determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole or part of the capital benefits, the capital benefits will be treated as unfranked dividends paid out of the company's profile.

59. Based on the information provided and having regard to the circumstances of the scheme, section 45A of the ITAA 1936 will not apply to the whole or any part of any demerger benefit provided to SRL shareholders and the Commissioner will not make a determination under subsection 45A(2) that section 45C of the ITAA 1936 applies.

Section 45B

60. 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).

61. 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.

62. 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 SRL shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

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

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital benefit
- capital gains
- CGT capital proceeds
- CGT events G1-G3 – shares
- cost base adjustments
- demerger
- demerger roll-over
- return of capital on shares

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 45
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45B
- ITAA 1936 45B(1)

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 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1997
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-70
 - ITAA 1997 125-80(1)
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 - ITAA 1997 Div 197
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ATO references

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