


# ***CR 2017/63 - Income tax: demerger of Yum China Holdings, Inc. by Yum! Brands, Inc.***

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## Class Ruling

### Income tax: demerger of Yum China Holdings, Inc. by Yum! Brands, Inc.

Contents	Para
<b>LEGALLY BINDING SECTION:</b>	
<b>Summary – what this ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>7</b>
<b>Scheme</b>	<b>8</b>
<b>Ruling</b>	<b>31</b>
<b>NOT LEGALLY BINDING SECTION:</b>	
<b>Appendix 1:</b>	
<b><i>Explanation</i></b>	<b>46</b>
<b>Appendix 2:</b>	
<b><i>Detailed contents list</i></b>	<b>68</b>

**📌 This publication provides you with the following level of protection:**

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

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

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

## Summary – what this ruling is about

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

### Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) 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)
- 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 shareholders of Yum! Brands, Inc (Yum!) who:

- were listed on the share register of Yum! as at the Record Date for the distribution of shares in Yum China Holdings, Inc (Yum China). The Record Date was the close of business on 19 October 2016 (Eastern Time, United States of America (US))
- did not hold their shares in Yum! as revenue assets (as defined in section 977–50) nor as trading stock (as defined in subsection 995–1(1)) on the distribution date of 31 October 2016 (Eastern Time, US)
- were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the distribution date, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Yum! 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 a Yum! 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 8 to 30 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

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7. This Ruling applies from 1 July 2016 to 30 June 2017. The Ruling continues to apply after 30 June 2017 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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## Scheme

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8. The following description of the scheme is based on information provided by the applicant.

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

### Introduction

9. Yum! is the ultimate parent company of a multinational group of companies engaged in the development, operations, franchising and licensing of quick service restaurants. Yum! (formerly named TRICON Global Restaurants Inc. (Tricon) was incorporated under the *North Carolina Business Corporation Act in 1997*. Tricon common stock began trading on the New York Stock Exchange (NYSE) on 7 October 1997.

10. At 3 September 2016, Yum! operated, franchised or licensed a worldwide system of restaurants in many countries, primarily through the concepts of KFC, Pizza Hut and Taco Bell (Yum! Brands).

11. Under each of the Yum! Brands, restaurants are either:

- (a) owned and operated by Yum!, these are known as Equity Stores, or
- (b) operated by independent franchisees or licensees under the terms of franchise or license agreements, known as the Franchise Business.

12. On 20 October 2015, Yum! announced its intention to separate from Yum China to become two independent publicly traded companies, each with distinct strategies and investment characteristics:

- (a) Yum China operates the China business, where nearly all of the stores are Equity Stores, and
- (b) Yum! operates its remaining businesses (including franchising) throughout the rest of the world.

13. On 31 October 2016, Yum! carried out a demerger of 100% of the shares in its wholly owned subsidiary, Yum China.

14. After the demerger, Yum! and Yum China have been and will continue to be operated as separate companies consistent with the intention of the demerger.

15. Yum China is a US company listed on the NYSE on 1 November 2016. Yum China's operational headquarters are located in the People's Republic of China.

## Reasons for the demerger

16. No shareholder approval was required for the separation. The Chief Executive Officer of Yum! provided an explanation of the commercial justifications for the demerger in a statement on 20 October 2015:

Following the separation, each standalone company will be able to intensify focus on its distinct commercial priorities, allocate its own resources to meet the needs of its business and pursue distinct capital structures and capital allocation strategies. This will provide a clear investment thesis and visibility to attract a long-term investor base suited to each business.

...

Yum! Brands will have a more stable earnings stream typical of a franchise company powered by industry-leading brands, while also benefiting from the development of the China business as a unique growth engine. In turn, our China business is self-sufficient and scalable with strong leadership in place, and is well-positioned to realise its full potential as a standalone business to capture the compelling opportunities in China.

17. The Yum China Information Statement, issued on 10 July 2016, advised of the board of directors and management view that the demerger was in the best interests of Yum! and its shareholders for a number of reasons, including enhanced strategic management and focus, more efficient allocation of capital, direct access to capital markets, alignment of incentives with performance objectives, investor choice and optimised capital structure.

18. The demerger created two distinct companies, which enabled:

- each company to maximise the effectiveness of their business in the market. The Equity Stores and Franchise Business are fundamentally distinct business models with different capital needs and investment profiles, and different strategies for achieving returns, and
- the risk and volatility associated with the China restaurant business to be isolated from Yum!. This resulted in two different investment profiles – (i) Yum China, with a higher volatility but a potential for a

higher return and (ii) Yum!, with lower volatility and more stable return.

### **Ownership interests in Yum!**

19. As at 31 October 2016, Yum! had on issue:

- 363,758,219 shares of common stock.
- Yum! Employee Equity Based Awards (Share-based and Deferred Compensation Plans). Those that applied for Australian employees were:
  - 1,368 stock options – the holders have the option to buy shares of Yum! stock in the future for ten years at a pre-determined fixed price.
  - 21,907 Stock Appreciation Rights (SARs) – the holders are entitled to receive, in cash or Yum! stock, at the time of exercise.
  - 863,000 Restricted Stock Units (RSUs) and Performance Share Units (PSUs) – These plans give the holders the right to receive a share of Yum! stock once the vesting period is complete.
- Approximately 274 participants in the Plans were based in Australia.
- Approximately less than 3% of the total shares of common stock in Yum! were held by Australians shareholders. The Australian shareholders represented approximately less than 1.5% of Yum! Shareholders at the Record Date.

### **Pre-demerger steps**

20. To facilitate the demerger, Yum! incorporated Yum China on 1 April 2016. Yum! held 100% of the Yum China common stock from the time of its incorporation until immediately prior to the demerger.

21. Yum! undertook a series of corporate restructuring transactions during 2016 in order to facilitate the transfer of all the relevant China business to Yum China.

22. On 23 September 2016, the Yum! Board of Directors approved a distribution of one share of Yum China common stock for each share of Yum! common stock held at the close of business on the Record Date.

## The demerger

23. On 31 October 2016 (the Demerger Date), the demerger was effected by way of Yum! making an in specie distribution of 100% of shares in Yum China to Yum! shareholders.

24. The distribution was made on a pro rata basis. Yum! shareholders received one share of Yum China common stock for every share of Yum! common stock held on the Record Date.

25. Immediately before the demerger, the Yum! shareholder equity accounts showed a balance of the Yum! common stock account (the account Yum! keeps of its contributed capital) of nil, and a retained earnings account in accumulated deficit (for example, had a negative balance). To account for the distribution of Yum China shares, Yum! further debited its retained earnings account.

26. The amount of US\$1,932,000,000 which was debited to the balance of Yum!'s retained earnings account was the carrying value that was attributable to Yum China.

## Other matters

27. The five day volume weighted average share price (VWAP) for Yum! and Yum China common stock on trading on the NYSE over the five days following the demerger was US\$60.47 and US\$26.78, respectively.

28. Immediately prior to the demerger, Yum China held no interests in Yum! and no company or trust owned or had the right to acquire more than 20% of Yum! shares.

29. No members of the Yum! group own shares in Yum!.

30. This Ruling is made on the following basis:

- Yum! will not make an election under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 do not apply to the total demerger dividend for all shareholders, and
- just after the demerger, at least 50% by market value, of all the CGT assets owned by Yum China and its 'demerger subsidiaries' (as defined in section 125-65(6)) will be used, directly or indirectly, in a business carried on by one or more of those entities.

## Ruling

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### Demerger roll-over relief

31. Yum! and its subsidiary Yum China were part of a demerger group for which Yum! is the head entity under subsection 125-65(1).

32. A demerger, as described under subsection 125-70(1), happened under the scheme and a CGT event happened in relation to each of the shares in Yum! common stock owned by Yum! Shareholders.

33. Therefore, Yum! Shareholders can choose demerger roll-over relief under subsection 125-55(1) in relation to their shares in Yum! common stock.

#### **CGT consequences of choosing demerger roll-over relief**

34. For Yum! Shareholders who choose demerger roll-over relief any capital gain or any capital loss made in respect of the CGT event that happened to their shares in Yum! common stock under the demerger is disregarded (subsection 125-80(1)).

#### **CGT consequences of not choosing demerger roll-over relief**

35. Yum! Shareholders who do not choose demerger roll-over relief may make a capital gain or a capital loss in respect of the CGT event that happened to their shares in Yum! common stock under the demerger. However, any capital gain made will be reduced to nil by the CGT anti-overlap rule in section 118-20.

#### **Cost base adjustments**

36. Yum! Shareholders must recalculate the first element of the cost base and reduced cost base of their Yum! shares and calculate the cost base and reduced cost base of their new Yum China shares (subsection 125-80(2)).

37. The first element of the cost base and reduced cost base of each Yum! share and corresponding Yum China share received under the demerger is worked out as follows:

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

38. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Yum! and Yum China shares, or a reasonable approximation of those market values (subsection 125-80(2) and 125-80(3)).

39. For the purposes of the cost base and reduced cost base apportionment under subsections 125–80(2) and 125–80(3), the Commissioner accepts that a reasonable approximation of the market values (just after the demerger) is provided by the VWAP of Yum! and Yum China shares as traded in the ordinary course of trading on the NYSE over the first five days from the Demerger Date (31 October 2016).

40. Based on the VWAP calculated (see paragraph 27 above) and the distribution ratio under the demerger of one Yum China share for one Yum! share held (paragraph 24 above), the Commissioner accepts that a reasonable apportionment of the total cost base of the Yum! shares just before the demerger is to:

- (a) attribute 30.69% of the total cost base or reduced cost base to the Yum China shares just after the demerger, and
- (b) attribute 69.31% of the total cost base or reduced cost base to the Yum! shares just after the demerger.

### **Acquisition date of the Yum China shares**

41. For general CGT purposes, Yum! Shareholders acquired their Yum China shares on the Demerger Date, 31 October 2016 (subsection 109–5(2)). For the operation of the CGT discount rules, Yum! Shareholders are taken to have acquired their Yum China shares on the date when they acquired their Yum! common stock: (subsection 115-30(1)).

### **Dividend consequences**

42. The distribution of Yum China shares constitutes both a demerger allocation and a dividend (subsection 6(1) of the ITAA 1936).

43. The demerger dividend is not assessable income or exempt income of Yum! Shareholders (subsection 44(4) of the ITAA 1936).

### **Section 45A of the ITAA 1936**

44. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in respect of the whole, or any part, of the distribution of Yum China shares to Yum! Shareholders under the demerger.

**Section 45B of the ITAA 1936**

45. The Commissioner will not make a determination under section 45B of the ITAA 1936 that either section 45BA of the ITAA 1936 or section 45C of the ITAA 1936 applies to the whole or any part of the distribution of Yum China shares to Yum! Shareholders under the demerger.

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**Commissioner of Taxation**13 September 2017

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## Appendix 1 – Explanation

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**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.*

### CGT consequences

#### ***Demerger roll-over relief***

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

47. The demerger roll-over provision in Division 125 contains a number of conditions for eligibility to choose roll-over relief. Each of the following conditions must be present for a demerger to qualify for roll-over relief:

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

48. A shareholder in a company may, at the time of a demerger, choose to obtain demerger roll-over relief if the conditions in subsection 125-55(1) and the requirements of a demerger in subsection 125-70(1) are satisfied.

49. Yum! Shareholders can choose to obtain demerger roll-over relief because the conditions under subsection 125-55(1) are satisfied:

- each Yum! Shareholder owned a share in Yum! common stock (original interest) (paragraph 125-55(1)(a))
- Yum! was the head entity of Yum! demerger group comprising Yum! and Yum China (paragraph 125-55(1)(b))
- a demerger happened to the Yum! demerger group (paragraph 125-55(1)(c)), and
- under the demerger, a CGT event happened to the original interest and the Yum! Shareholders acquired shares in Yum China common stock (new interest) (paragraph 125-55(1)(d)).

50. A demerger as described in section 125–70 happened under the scheme because:

- there was a restructuring of the Yum! demerger group (paragraph 125–70(1)(a))
- under the restructuring, Yum! disposed of at least 80% of its total ownership interests in Yum China to Yum! shareholders (subparagraph 125–70(1)(b)(i), and
- under the restructure:
  - a CGT event happened in relation to the Yum! shares held by Yum! Shareholders and Yum! Shareholders acquired new Yum China shares and nothing else (subparagraph 125–70(1)(c)(i))
  - the Yum China shares were acquired by Yum! Shareholders because of their ownership interests in Yum! (paragraph 125–70(1)(d) and subparagraph 125–70(1)(e)(i))
  - paragraph 125–70(1)(g) were satisfied since neither Yum! nor Yum China is a trust that is a superannuation fund
  - each Yum! Shareholder acquired Yum China shares in the same proportion as they owned Yum! shares just before the demerger (paragraph 125–70(2)(a))
  - each Yum! Shareholder owned, just after the demerger, the same proportionate market value of Yum! and Yum China shares as they owned in Yum! just before the demerger (paragraph 125–70(2)(b)), and
  - subsections 125–70(4) and (5) have no application.

### ***Demerger dividend***

51. As no part of the distribution was debited to Yum!’s share capital account, the entirety of value of the distribution is a dividend (subsection 6(1) of the ITAA 1936).

52. A dividend is treated as not assessable income or exempt income under subsection 44(4) of the ITAA 1936 if:

- the dividend is a demerger dividend
- the head entity does not elect for subsections 44(3) and 44(4) to not apply to the dividend, and
- just after the demerger, CGT assets owned by the demerged entity or a demerger subsidiary representing at least 50% by market value of all the CGT assets (or

a reasonable approximation of market value) owned by the demerged entity and its demerger subsidiaries are used, directly, or indirectly in one or more businesses carried on by one or more of those entities (subsection 44(5)).

53. Subsection 6(1) of the ITAA 1936 defines 'demerger dividend' to mean that part of a demerger allocation that is assessable as a dividend under subsection 44(1) of the ITAA 1936 or that would be so assessable apart from subsection 44(3) and (4).

54. In this case, the distribution constitutes a 'demerger allocation' as defined in subsection 6(1) of the ITAA 1936.

55. As the entire distribution constitutes both a 'dividend' and a 'demerger allocation', the entire distribution constitutes a 'demerger dividend' as defined in subsection 6(1) of the ITAA 1936.

56. Yum!, as the head entity of the demerger group did not elect that subsections 44(3) and 44(4) of the ITAA 1936 will not apply to the demerger dividend.

57. Subsection 44(5) is satisfied as just after the demerger, at least 50% by market value, of all the CGT assets owned by Yum China and its 'demerger subsidiaries' will be used, directly or indirectly, in the business carried on by Yum China and its subsidiaries.

58. As each of the conditions are satisfied, the demerger dividend received by Yum! Shareholders will not be assessable income or exempt income under subsection 44(4) of the ITAA 1936.

## **Section 45A of the ITAA 1936**

59. 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.

60. Under the scheme, Yum! did not stream the provision of capital benefits to its shareholders. All Yum! Shareholders received the same distribution and thus obtained the same benefits under the arrangement.

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

**Section 45B of the ITAA 1936**

62. 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).

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

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company
- (b) under the scheme the taxpayer obtains a tax benefit as defined in subsection 45B(9) of the ITAA 1936, and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling the taxpayer to obtain the tax benefit.

64. Where the requirements of subsection 45B(2) of the ITAA 1936 are met, subsection 45B(3) 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.

65. In this case, the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 are met. However, having considered the relevant circumstances of the scheme, it is concluded the requisite purpose of enabling the Yum! Shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

66. The conclusion as to purpose in relation to the demerger benefit is made with regard to factors set out in subsection 45B(8) of the ITAA 1936 and takes into account a range of relevant matters including the reasons for the demerger and the proportion of Australian tax resident Yum! shareholders.

67. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(a) or paragraph 45B(3)(b) of the ITAA 1936 that section 45BA or section 45C of the ITAA 1936 applies.

## **Appendix 2 – Detailed contents list**

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

	<b>Paragraph</b>
<b>Summary – what this ruling is about</b>	<b>1</b>
Relevant provision(s)	2
Class of entities	3
Qualifications	4
<b>Date of effect</b>	<b>7</b>
<b>Scheme</b>	<b>8</b>
Introduction	9
Reasons for the demerger	16
Ownership interests in Yum!	19
Pre-demerger steps	20
The demerger	23
Other matters	27
<b>Ruling</b>	<b>31</b>
Demerger roll-over relief	31
CGT consequences of choosing demerger roll-over relief	34
CGT consequences of not choosing demerger roll-over relief	35
Cost base adjustments	36
Acquisition date of the Yum China shares	41
Dividend consequences	42
Section 45A of the ITAA 1936	44
Section 45B of the ITAA 1936	45
<b>Appendix 1 – Explanation</b>	<b>46</b>
CGT consequences	46
<i>Demerger roll-over relief</i>	46
<i>Demerger dividend</i>	51
Section 45A of the ITAA 1936	59
Section 45B of the ITAA 1936	62
<b>Appendix 2 – Detailed contents list</b>	<b>68</b>

## References

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### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 2003/8; TR 2006/10

### *Legislative references:*

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- ITAA 1936 Div 16K Pt III
- ITAA 1936 6(1)
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- ITAA 1936 44(2)
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 44(5)
- ITAA 1936 45
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- ITAA 1936 45B
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- ITAA 1936 45B(2)
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- ITAA 1997 125-70(1)(g)
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- ITAA 1997 125-70(4)
- ITAA 1997 125-70(5)
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 rules ~~ Section 45C

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