

CR 2011/66 - Income tax: demerger of Echo Entertainment Group Limited by Tabcorp Holdings Limited

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Class Ruling

Income tax: demerger of Echo Entertainment Group Limited by Tabcorp Holdings Limited

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	9
Ruling	32
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	49
Appendix 2:	
<i>Detailed contents list</i>	72

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

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Tabcorp Holdings Limited (THL) who:

- (a) participated in the scheme that is the subject of this Ruling;
- (b) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Implementation Date of 15 June 2011 for that scheme;
- (c) owned ordinary shares in THL (THL shares) and held those shares on capital account on the Record Date of 10 June 2011; and
- (d) are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their THL 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 'THL 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 31 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. On 15 June 2011 THL carried out a demerger of all the shares in its wholly owned subsidiary, Echo Entertainment Group Limited (Echo). The demerger, which was announced by the THL Board on 18 October 2010, formed the central component of a restructuring of the THL Group which created a structural separation and separate stock exchange listing for THL's casinos division.

Relevant Entities

THL

11. THL is an Australian resident public company listed on the Australian Securities Exchange (ASX) and the head company of an Australian consolidated tax group for the purposes of Part 3-90 of the ITAA 1997.

12. Prior to the demerger, THL's business was comprised of three divisions, namely the gaming division, the wagering division and the casinos division.

13. Immediately before the demerger THL had on issue 688,019,737 fully paid ordinary shares.

14. THL operated various employee share and option plans. At the time of the demerger the outstanding ownership interests in THL acquired under these plans were as follows:

- There were 52,232 outstanding performance options granted under the Long Term Performance Plan (LTPP). The LTPP included a clause which ensured that, in the event of a reorganisation of ordinary share capital of THL, the exercise price of these performance options would be adjusted to account for the reorganisation. Furthermore, they represented not more than 10% of the ownership interests in THL.
- There were 232,136 outstanding performance rights granted under the LTPP. These performance rights were beneficial interests in the ownership interest of THL under an employee share scheme, and Subdivision 83A-C of the ITAA 1997 applied to these beneficial interests. They represented not more than 3% of the total ownership interests in THL (taking into account both their number and value).
- There were 729,315 THL shares that were acquired under the THL Deferred Share Plan (DSP).

15. Employees holding shares issued under an employee share or option plan participated in the demerger on the same basis as all other THL shareholders.

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

Echo

17. Echo was incorporated in Victoria shortly prior to the demerger and became a wholly owned subsidiary of THL at the time of its incorporation. It was incorporated for the purposes of holding, prior to the demerger, either directly or indirectly, all THL entities and assets relating to the casinos division.

Pre-demerger transactions

18. Prior to the demerger, THL undertook certain transactions to facilitate the demerger including:

- entering into an Implementation Deed;
- entering into a Demerger Deed; and
- undertaking an internal corporate restructure to ensure that Echo, either directly or indirectly, owned all the companies and assets comprising the casinos division and THL owned all the companies and assets relating to the wagering and gaming divisions.

The demerger of Echo

19. The demerger of Echo was carried out by a capital reduction and a court approved scheme of arrangement, both of which were approved by the requisite majorities of THL shareholders on 1 June 2011.

20. The demerger was implemented according to its terms on 15 June 2011 (the Implementation Date). On that day THL reduced its share capital in the amount of approximately \$3.2264 per THL share (the capital reduction amount) and in aggregate \$2,219,808,249.

21. In accordance with the terms of the scheme of arrangement, the capital reduction was satisfied by THL shareholders receiving an *in specie* distribution of one Echo share for every THL share they owned on the Record Date of 10 June 2011.

22. The holders of outstanding performance options in THL did not receive shares or options in Echo under the demerger. However, the exercise price of each option was adjusted to reflect the diminution of value in THL shares resulting from the implementation of the scheme of arrangement.

Sale Facility

23. A Sale Facility was made available for Ineligible Overseas Shareholders to enable their demerged Echo shares to be sold on the ASX and the net proceeds remitted to them after deduction of any applicable brokerage, stamp duty and other selling costs, taxes and charges.

24. Ineligible Overseas Shareholders were Scheme Shareholders other than Eligible Shareholders as specified in the Scheme Booklet.

Accounting for the distribution to effect the demerger

25. The Echo shares were acquired by THL shareholders by applying the following amounts distributed to them by THL to the acquisition of those Echo shares:

- the capital reduction amount – being a return of share capital in the amount of approximately \$3.2264 on each THL share; and
- the balance of the demerger distribution on a per share basis.

26. THL accounted for the distributions that effected the demerger by debiting its share capital account by \$2,219,808,249 (the total capital reduction) and its demerger reserve account by the balance of the demerger distribution.

Reasons for the demerger

27. THL expected that a number of advantages would accrue to its shareholders as a result of the demerger. The key advantages were said to:

- ensure that Echo benefits from material capital investment and that THL is well positioned within a rapidly evolving retail and online gaming environment;
- provide greater investment choice for existing and new investors; and
- allow special purpose management teams to focus on the development of their respective business plans, customers and industry partners.

Other matters

28. THL has confirmed that as at the implementation date, its share capital account (as defined in section 975-300 of the ITAA 1997) was not tainted within the meaning of Division 197 of the ITAA 1997.

29. Echo was listed on the ASX, first trading on 6 June 2011 initially on a deferred settlement basis.

30. Just after the demerger, at least 50% of the market value of capital gains tax assets owned by Echo or its subsidiaries was used directly or indirectly in one or more businesses carried on by Echo or any of its subsidiaries.

31. There was no off-market buy-back of shares under this scheme, or circumstances where THL shareholders could obtain roll-over under another provision of the ITAA 1997.

Ruling

CGT consequences

CGT event G1

32. CGT event G1 happened in relation to each of the THL shares owned by THL shareholders at the time of the capital reduction (section 104-135 of the ITAA 1997).

33. THL shareholders made a capital gain when CGT event G1 happened in relation to each of their THL shares if the capital reduction amount exceeded the cost base of the THL 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) of the ITAA 1997).

Demerger roll-over

34. THL and its subsidiary Echo are part of a demerger group under subsection 125-65(1) of the ITAA 1997.

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

36. THL shareholders can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their THL shares.

THL shareholders who choose demerger roll-over

37. A THL shareholder who chooses demerger roll-over will disregard any capital gain made when CGT event G1 happened in relation to each of their THL shares under the demerger (subsections 125-55(1) and 125-80(1) of the ITAA 1997).

38. A THL shareholder who chooses demerger roll-over for their THL shares is required to recalculate the cost base and reduced cost base of their THL and Echo shares.

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

- take the sum of the cost bases of the THL shares (just before the demerger); and
- apportion that sum over the THL shares and corresponding new Echo 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 THL and Echo shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

41. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3) of the ITAA 1997, the Commissioner accepts the volume weighted average price of the Echo shares, \$4.2711, and the THL fully paid ordinary shares, \$3.3067, as traded on the ASX (whether on a deferred or normal settlement basis) over the first five trading days after the Effective Date, 3 June 2011 as a reasonable approximation of the relative market value of those shares.

THL shareholders who do not choose demerger roll-over

42. For a THL shareholder who does not choose demerger roll-over:

- the shareholder is not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their THL shares under the demerger; and
- the first element of the cost base and reduced cost base of each THL share and the corresponding Echo share is calculated in the manner described in paragraph 39 of this Ruling (subsection 125-85(1) and 125-85(2) of the ITAA 1997).

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

43. For the purposes of determining eligibility for a discount capital gain, the Echo shares received by a THL shareholder are taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding THL shares (item 2 in the table in subsection 115-30(1) of the ITAA 1997). This is the case irrespective of whether demerger roll-over relief is chosen or not.

Demerger dividend

44. Any dividend arising under the demerger is a demerger dividend (subsection 6(1) of the ITAA 1936).

45. Any demerger dividend is neither assessable income nor exempt income of the participating THL shareholders (subsections 44(3) and 44(4) of the ITAA 1936).

46. As the share capital reduction amount was debited to THL's share capital account it is not a dividend, as defined in subsection 6(1) of the ITAA 1936 (see the exclusion outlined in paragraph (d) of the definition of a dividend contained in subsection 6(1) of the ITAA 1936).

Application of sections 45B, 45BA and 45C of the ITAA 1936

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 THL 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 THL shareholders under the demerger.

Commissioner of Taxation29 June 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.*

CGT consequences

49. 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.

50. A significant tax consequence of the Scheme is the availability of demerger roll-over under Division 125 of the ITAA 1997. Broadly, resident THL shareholders can choose roll-over to disregard a capital gain made under the demerger.

51. There are special rules for calculating the cost base and reduced cost base of the THL and Echo shares for THL shareholders regardless of whether or not they choose roll-over.

Conditions for demerger roll-over

52. The conditions for roll-over under Division 125 of the ITAA 1997 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’ and ‘employee share schemes’ under the proportion test in determining whether a demerger happens to a demerger group.

53. One of the conditions for a demerger happening to a demerger group is the ‘proportion’ test in subsection 125-70(2) of the ITAA 1997. 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.

Adjusting instruments

54. The performance options granted under the LTPP are ownership interests for the purpose of the proportion test. However, section 125-75 of the ITAA 1997 provides for various exceptions to the proportion test including an exception for certain 'adjusting instruments' representing not more than 10% of the ownership interests of a listed public company (subsections 125-75(4) and 125-75(5) of the ITAA 1997).

55. The performance options granted under the LTPP represent significantly less than 10% of the ownership interests in the company. They account for 0.0076% by number and less than 10% by value of THL's ownership interests. Further, the exercise price of the options will be adjusted taking into account the capital reduction amount of a demerger allocation and the market value of the Echo shares. For these reasons, it is considered that the performance options can be disregarded for the purposes of the proportion test.

Employee share schemes

56. The performance rights granted under the LTPP are also ownership interests for the purposes of the proportion test.

57. Relevantly, subsection 125-75(1) of the ITAA 1997 also provides for an exception to the proportion test for certain employee share scheme ownership interests representing not more than 3% of the total ownership interests in a company.

58. The performance rights granted under the LTPP represent significantly less than 3% of the ownership interests in the company. They account for approximately 0.0337% by number and less than 3% by value of THL's ownership interests. In addition they meet the requirements of subsection 125-75(2) of the ITAA 1997 (that is, they were beneficial interests in the ownership interest of THL under an employee share scheme, Subdivision 83A-C of the ITAA 1997 applied to these beneficial interests, and the ownership interest is not a fully-paid ordinary share). For these reasons, it is considered that the performance rights can be disregarded for the purposes of the proportion test.

59. Furthermore, it is noted that the total percentage of ownership interests disregarded under both these exceptions (i.e. 'adjusting instruments' under subsection 125-75(1) of the ITAA 1997 and 'employee share schemes' under subsection 125-75(4) of the ITAA 1997) did not exceed 20% of the ownership interests in THL (subsection 125-75(7) of the ITAA 1997).

Demerger dividend

60. 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.
61. 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.
62. 'Share capital account' is defined in section 975-300 of the ITAA 1997 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.
63. 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.
64. In the circumstances of this demerger, THL will debit an amount of \$2,219,808,249 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.
65. However, THL shareholders did receive a dividend to the extent that the market value of the Echo shares distributed under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).
66. 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.
67. In the present circumstances, as each of the conditions outlined in paragraph 66 of this Ruling are satisfied, the dividend received by THL shareholders under the demerger will be neither assessable income nor exempt income as per the operation of subsections 44(3) and 44(4) of the ITAA 1936.

Application of section 45B of the ITAA 1936

68. The purpose of section 45B of the ITAA 1936 is to ensure that relevant amounts distributed to shareholders of a company are treated as dividends for tax 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).

69. Subsection 45B(2) of the ITAA 1936 relevantly provides 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.

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 THL 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 45B(3)(b) of the ITAA 1936 that either section 45BA or 45C of the ITAA 1936 applies to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

72. 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	4
Date of effect	8
Scheme	9
Background	10
Relevant entities	11
<i>THL</i>	11
<i>Echo</i>	17
Pre-demerger transactions	18
The demerger of Echo	19
Sale Facility	23
Accounting for the distribution to effect the demerger	25
Reasons for the demerger	27
Other matters	28
Ruling	32
CGT consequences	32
<i>CGT event G1</i>	32
Demerger roll-over	34
THL shareholders who choose demerger roll-over	37
THL shareholders who do not choose demerger roll-over	42
Acquisition date of the Echo shares for the purposes of the CGT discount	43
Demerger dividend	44
Application of sections 45B, 45BA and 45C of the ITAA 1936	47
Appendix 1 – Explanation	49
CGT consequences	49
Conditions for demerger roll-over	52
<i>Adjusting instruments</i>	54
<i>Employee share schemes</i>	56
Demerger dividend	60
Application of section 45B of the ITAA 1936	68
Appendix 2 –Detailed contents list	72

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- ITAA 1936 45B(3)(b)
 - ITAA 1936 45B(9)
- Not previously issued as a draft
- ITAA 1936 45BA
- Related Rulings/Determinations:*
- ITAA 1936 45C
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- capital gains
 - CGT events
 - CGT events G1-G3 – shares
 - CGT capital proceeds
 - cost base adjustments
 - demerger
 - demerger allocation
 - demerger benefit
 - demerger dividend
 - demerger group
 - demerger subsidiary
 - return of capital on shares
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