


CR 2011/76 - Income tax: demerger of TNT Mines Limited by Minemakers Limited

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Class Ruling

Income tax: demerger of TNT Mines Limited by Minemakers Limited

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

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

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

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

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant 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;
- Division 125 of the ITAA 1997; and
- Division 197 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies consists of the ordinary shareholders of Minemakers Limited (Minemakers) who at the Record Date:

- (a) were listed on the share register of Minemakers;
- (b) were residents of Australia, as defined in subsection 6(1) of the ITAA 1936;
- (c) held their Minemakers shares on capital account; and
- (d) are not subject to the taxation of financial arrangements (TOFA) rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Minemakers shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

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 20 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 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 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 released under Freedom of Information legislation.

Background

10. Minemakers is a company listed on the Australian Securities Exchange (ASX). Minemakers owned 100% of the issued capital in Minemakers TTT Pty Limited (Minemakers TTT) at the commencement of this scheme.

11. On 25 March 2011, Minemakers had on issue:

- 227,003,950 ordinary shares;
- 7,675,000 options held by employees and contractors; and
- 12,500,000 options held by directors and the company secretary.

The Demerger

12. On 24 November 2010, Minemakers announced to the ASX that it intended to restructure its operations by demerging 80% of Minemakers TTT and renaming that company 'TNT Mines Limited' (TNT). TNT would then concentrate on exploiting existing mineral tenements in Tasmania.

13. The demerger was approved by Minemakers shareholders on 3 June 2011 and the Record Date was 14 July 2011.

14. On the Implementation Date, which was 19 July 2011, Minemakers effected the demerger of 80% of TNT by an *in specie* distribution. The accounting entries reflecting the demerger were a debit to its share capital account (the capital reduction amount), a debit to a demerger revaluation reserve and a credit to 'Investment in Subsidiary – TNT.'

15. Under the demerger, Minemakers shareholders received one TNT share for every 4.54 Minemakers shares they held on the Record Date. After the demerger, TNT also applied for listing on the ASX.

The Distribution

16. The distribution of TNT shares to Minemakers ordinary shareholders represented a return of capital and a dividend for each Minemakers share they held at the Record Date:

- (a) the return of capital was the amount debited by Minemakers against its share capital account and applied equally against each ordinary Minemakers share; and
- (b) the dividend component was the difference between the market value of TNT on the Implementation Date and the amount that Minemakers debited to its share capital account, and applied equally against each ordinary Minemakers share.

Other Matters

17. Before the demerger, Minemakers had provided funding to Minemakers TTT by inter-company loans, with the inter-company balance standing at approximately \$2.1 million. This balance was converted into equity, before the demerger, with 62,499,900 shares being issued to Minemakers.

18. None of the Minemakers shares were acquired before 20 September 1985. Minemakers' share capital account has not been tainted within the meaning of Division 197 of the ITAA 1997.

19. Minemakers will not elect under subsection 44(2) of the ITAA 1936 for subsections 44(3) and 44(4) not to apply to the demerger dividend.

20. CGT assets representing more than 50% of the market value of all the CGT assets of TNT will be used directly or indirectly in a business that it carries on just after the demerger.

Ruling

CGT consequences

CGT event G1

21. CGT event G1 happens in relation to each of the Minemakers ordinary shares owned by a Minemakers shareholder at the time of the return of capital (section 104-135).

22. A Minemakers shareholder makes a capital gain under CGT event G1 if the return of capital received for each Minemakers share exceeds the cost base of that share. The capital gain is equal to the amount of the excess. You cannot make a capital loss from CGT event G1 (subsection 104-135(3)).

Demerger roll-over

23. Minemakers and its subsidiary TNT are part of a demerger group under subsection 125-65(1).

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

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

CGT consequences of choosing roll-over

26. A Minemakers shareholder who chooses demerger roll-over disregards any capital gain made when CGT event G1 happens to their Minemakers shares under the demerger (subsection 125-80(1)).

Other consequences of choosing roll-over

27. A Minemakers shareholder who chooses roll-over for their Minemakers shares is required to recalculate the cost base and reduced cost base of their Minemakers and TNT shares.

28. The first element of the cost base and reduced cost base of each Minemakers share and corresponding TNT shares received under the demerger is worked out as follows:

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

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

Minemakers shareholders who do not choose demerger roll-over

30. A Minemakers shareholder who does not choose demerger roll-over:

- is not entitled to disregard any capital gain made when CGT event G1 happened to their Minemakers shares under the demerger; and
- the first element of the cost base and reduced cost base of each Minemakers share and corresponding TNT share is calculated in the manner described in paragraphs 28 and 29 of this Ruling (subsections 125-85(1) and 125-85(2)).

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

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

Dividend consequences

Demerger Dividend

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

33. The demerger dividend is neither assessable income nor exempt income of a Minemakers' shareholder (subsections 44(3) and (4) of the ITAA 1936).

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

Application of sections 45B, 45BA and 45C

35. The Commissioner will not make a determination under paragraph 45B(3)(a) of the ITAA 1936 that section 45BA applies to the whole or any part of any demerger benefit provided to a Minemakers shareholder under the demerger.

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

Commissioner of Taxation10 August 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

37. The tax consequences and the relevant legislative provisions concerning the scheme are outlined in the Ruling part of this document.

38. A significant tax consequence is the availability of demerger roll-over relief in Division 125 which enables Minemakers shareholders to disregard a capital gain made under the demerger.

39. There are special rules for calculating the cost base and reduced cost base of the Minemakers and TNT shares whether or not roll-over is chosen.

40. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and 125-80(3), a reasonable approximation of the relative market value of the share would be the volume weighted average price of the Minemakers shares, as traded on the ASX (whether on a deferred or normal settlement basis) over its first five trading days and the market value of the shares in TNT at the date of demerger.

Adjusting instruments

41. One of the conditions in Division 125 is the 'proportion' test in subsection 125-70(2). This test 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.

42. The options on issue by Minemakers are ownership interests but 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)).

43. The Minemakers options are 'adjusting instruments' and account for 8.16% by number and approximately 6.22% by value of the ownership interests in Minemakers. The options have been issued on terms under which the exercise price will be reduced by the amount of the capital component of a demerger allocation. It is considered that the options should be disregarded for the purposes of the 'proportion' test in subsection 125-70(2).

Conditions for demerger roll-over relief

44. The conditions for roll-over under Division 125 are satisfied and the Ruling section provides a detailed explanation of the Commissioner's decision.

Demerger dividend

45. 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.

46. 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.

47. '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.

48. 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.

49. In the circumstances of this demerger, Minemakers will debit an amount of \$1.7 million to its 'share capital account' (as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300). 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 dividend under subsection 44(1) of the ITAA 1936.

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

51. 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 (subsection 44(2) of the ITAA 1936); and
- subsection 44(5) of the ITAA 1936 is satisfied.

52. In the present circumstances, as each of the conditions in paragraph 51 of this Ruling is satisfied, the dividend received by Minemakers 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.

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

53. 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.

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

55. 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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8; TR 2006/10

Subject references:

- capital benefit
- capital gains
- 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 45B(2)(b) |
| - ITAA 1936 44 | - ITAA 1936 45B(3) |
| - ITAA 1936 44(1) | - ITAA 1936 45B(3)(a) |
| - ITAA 1936 44(2) | - ITAA 1936 45B(3)(b) |
| - ITAA 1936 44(3) | - ITAA 1936 45BA |
| - ITAA 1936 44(4) | - ITAA 1936 45C |
| - ITAA 1936 44(5) | - ITAA 1997 104-135 |
| - ITAA 1936 45B | - ITAA 1997 104-135(3) |
| - ITAA 1936 45B(2)(a) | - ITAA 1997 115-30 |
| | - ITAA 1997 115-30(1) |
| | - ITAA 1997 Div 125 |
| | - ITAA 1997 125-55(1) |
| | - ITAA 1997 125-65(1) |
| | - ITAA 1997 125-70 |
| | - ITAA 1997 125-70(2) |
| | - ITAA 1997 125-75 |
| | - ITAA 1997 125-75(4) |
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| | - ITAA 1997 125-80(1) |
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| | - ITAA 1997 125-80(3) |
| | - ITAA 1997 125-85(1) |
| | - ITAA 1997 125-85(2) |
| | - ITAA 1997 Div 197 |
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ATO references

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G3 – shares
Income Tax ~~ Capital Gains Tax ~~ roll-overs – other
Income Tax ~~ Capital Gains Tax ~~ demerger relief