

CR 2014/66 - Income tax: demerger of Kogi Iron Limited by TGP Australia Limited

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Class Ruling

Income tax: demerger of Kogi Iron Limited by TGP Australia 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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provisions

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 109-5 of the 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 consists of the shareholders of TGP Australia Limited (TGP) who:

- (a) are listed on the share register of TGP as at the Record Date (11 July 2014)
- (b) are residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Record Date
- (c) hold their TGP shares on capital account on the Record Date; 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 TGP 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.)

4. In this Ruling, a person belonging to this class of entities is referred to as a 'TGP 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 9 to 36 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.

Date of effect

8. This Ruling applies from 1 July 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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. TGP has undertaken a demerger of 86.7% of its total shareholding in Kogi Iron Limited (Kogi Iron). The demerger proceeded on 11 July 2014 by way of an in specie distribution by TGP of its Kogi Iron shares to its shareholders.

Relevant entities

TGP

11. TGP is a public company limited by shares. It was incorporated on 10 May 2005. The company is not listed, and its shares are not quoted for trading, on a recognised stock exchange.

12. TGP is a resident of Australia for tax purposes.

13. The business of TGP is as an equity finance development company which identifies, acquires and develops mining, resources and oil and gas projects located in Australia and overseas with a particular emphasis in Africa.

14. TGP will acquire early stage resource projects. The intention is to develop these projects and to hold these investments for the long term.

15. TGP's objective is to invest in several new mining, resources or oil and gas projects in the next 12 months. It is currently in the process of evaluating specific projects.

Past Activities

16. TGP acquired exploration licences in Nigeria through its wholly owned subsidiary KCM Mining Holdings Pty Ltd (KCMH) which in turn owns 75% of KCM Mining Ltd (KCM), the registered holder of the Nigerian exploration licences.

17. In February 2011 TGP, through its subsidiary company KCM, arranged for the commencement of an initial exploration programme on the Nigerian exploration licences. Following the conclusion of the programme, the Agbaja Plateau was selected for initial drilling.

Kogi Iron

18. Kogi Iron is a public company whose ordinary shares are quoted for trading on the Australian Securities Exchange (ASX).
19. Immediately before the demerger, TGP held 85,766,667 Kogi Iron shares. The Kogi Iron shares were fully paid ordinary shares in the share capital of Kogi Iron.
20. TGP's shareholding in Kogi Iron represented 23.7889% of the total issued capital in Kogi Iron. That is, TGP held 85,766,667 ordinary shares in Kogi Iron and there were a total of 360,531,896 shares on issue. The remaining 76.2111% was held by numerous other shareholders.
21. During the year ended 30 June 2012, TGP acquired the Kogi Iron shares as consideration for the sale of shares TGP held in KCMH. Prior to this sale, KCMH was a wholly owned subsidiary of TGP. KCMH owned 75% of KCM and Kogi Iron acquired the other 25% of KCM from a third party not related to or associated with TGP.
22. TGP was the 75% economic owner of KCM and the Nigerian exploration licences. TGP considered that, in order to develop the Nigerian exploration licences, including carrying out drilling programs with the objective of defining a resource estimate, TGP would need to be able to access large amounts of capital. TGP considered listing on the ASX in its own right, so that it could access equity capital by issuing new shares. However, TGP decided to sell its KCMH shares to Kogi Iron because:
- (a) Kogi Iron was already listed and held cash
 - (b) TGP felt that Kogi Iron would have a greater chance of successfully relisting on the ASX as the new owner of the Nigerian exploration licences because Kogi Iron already had shareholder spread as a listed entity
 - (c) TGP felt that TGP would have a lesser chance of successfully listing on the ASX as an entity trying to list on the ASX for the first time
 - (d) TGP would still have an economic exposure to the Nigerian exploration licences and their prospects, by way of a large shareholding in Kogi Iron, and
 - (e) the officers of Kogi Iron had greater skills and experience in promoting share offers and raising funds for the development of the Nigerian exploration licences than TGP felt that it did.
23. Kogi Iron conducts a business which is focussed on the exploration and development of its 100% owned Agbaja Plateau Iron Ore Project located in Kogi State, Republic of Nigeria, West Africa.
24. Kogi Iron's assets do not comprise any property which is taxable Australian real property for the purposes of section 855-20 of the ITAA 1997.

The demerger

25. Under the distribution, which was approved by TGP's shareholders on 3 July 2014:

- (a) TGP transferred 86.7% of its Kogi Iron shares to its shareholders by way of an equal capital reduction for the purposes of the *Corporations Act 2001*, and
- (b) each shareholder (registered on the distribution Record Date) received a proportionate share of the Kogi Iron shares in accordance with their proportionate shareholding in TGP. No other distribution was received by the shareholders from TGP.

Accounting for the demerger

26. The demerger required two separate accounting steps:

- (a) revaluation to market value of Kogi Iron shares at the date of the distribution, and
- (b) distribution of Kogi Iron shares at market value.

27. A revaluation of the Kogi Iron shares on disposal to market value (at the time of disposal) was required. As the market value was less than the amount shown in the accounts for Kogi Iron shares, the revaluation generated a loss being the amount by which the market value was less than the value shown in the accounts. This difference arose because the value shown in the accounts was based on the equity accounting method whereas the market value as at the date of the distribution (and on the distribution) was determined applying VWAP (volume-weighted average price of Kogi Iron shares sold on the ASX for the five trading days immediately prior to the distribution date).

28. The revaluation resulted in a significant loss. When this loss was debited to TGP's retained earnings account, the balance of this account became an accumulated loss.

29. Accordingly, TGP accounted for the distribution by debiting its share capital account by the market value of the Kogi Iron shares (the capital reduction amount). That is, there was no dividend amount with respect to the distribution.

Reasons for the demerger

30. TGP's reasons for undertaking the demerger were as follows:

- it enables TGP to ensure that its strategic focus is on its core business of developing new mining, resources and oil and gas projects and not as a major shareholder in a publicly listed company

- it enables greater investor choice in that the risk profile of early stage resource projects is different than the risk profile of more developed projects
- individual shareholders will be able to choose whether or not to participate in Kogi Iron rights issues, share purchase plans and other fundraising offers in the future according to their own personal circumstances, removing uncertainty about:
 - TGP as a large shareholder being in a position to participate in Kogi Iron rights issues and other fundraising offers
 - whether or not TGP needs to seek and obtain capital in order to participate in any Kogi Iron rights issue and other fundraising offers
 - whether the capital could be raised by TGP within the time required.

31. More specifically, the demerger enables TGP to focus on its objective of investing in several new mining, resources or oil and gas projects in the next 12 months. It is in the process of evaluating specific projects. The projects will be funded by TGP through a capital raising programme. Kogi Iron's business is to focus on the Agbaja Plateau Iron Ore Project. If TGP had remained a shareholder in Kogi Iron, its focus on raising capital to fund its new projects would have been affected by the need to raise capital in order to participate in any Kogi Iron rights issue and other fundraising offers that Kogi Iron makes in order to further fund the Agbaja Plateau Iron Ore Project.

Other matters

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

33. Immediately prior to the demerger, TGP had no options on issue.

34. TGP's share capital account has not been tainted within the meaning of Division 197 of the ITAA 1997.

35. TGP will not make an election under subsection 44(2) of the ITAA 1936.

36. TGP has never paid a dividend to its shareholders.

Ruling

Capital gains tax (CGT)

CGT event G1

37. CGT event G1 happened in relation to each TGP share owned by a TGP shareholder at the time TGP made the payment of the capital reduction amount satisfied by the in specie distribution of Kogi Iron shares (section 104-135 of the ITAA 1997).

38. A TGP shareholder made a capital gain when CGT event G1 happened if the capital reduction amount for each TGP share exceeded the cost base of that 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

39. TGP and its subsidiary Kogi Iron are part of a demerger group under subsection 125-65(1) of the ITAA 1997.

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

41. A TGP shareholder can choose demerger roll-over under subsection 125-55(1) of the ITAA 1997.

CGT consequences of choosing demerger roll-over

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

43. If a TGP shareholder chooses demerger roll-over, they must also recalculate the cost base and reduced cost base of their TGP shares and calculate the cost base and reduced cost base of their new Kogi Iron shares.

44. The first element of the cost base and reduced cost base of each TGP share and corresponding Kogi Iron share received under the demerger is worked out as follows:

- sum the cost base of each TGP share (just before the demerger), and
- apportion that sum over the TGP shares and corresponding new Kogi Iron shares received under the demerger on a reasonable basis having regard to the market values (just after the demerger) of the TGP and Kogi Iron shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3) of the ITAA 1997).

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

- attribute 2.28% of the summed cost base to the TGP shares
- attribute 97.72% of the summed cost base to the Kogi Iron shares.

TGP shareholders who do not choose demerger roll-over

46. A TGP shareholder who does not choose demerger roll-over relief:

- is not entitled to disregard any capital gain made when CGT event G1 happened to their TGP shares under the demerger; and
- the first element of the cost base and reduced cost base of each TGP share and the corresponding Kogi Iron share is calculated in the same manner as if they had chosen demerger roll-over relief (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of Kogi Iron shares

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

48. For all other CGT purposes, a TGP shareholder acquired their Kogi Iron shares on the date that the Kogi Iron shares were transferred to them by TGP, being 11 July 2014 (subsection 109-5(2) of the ITAA 1997).

Dividend

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

50. As the entire amount of the market value of the Kogi Iron shares distributed was debited to TGP's share capital account, there is no demerger dividend.

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

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

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

Commissioner of Taxation20 August 2014

Appendix 1 – Explanation

① *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

53. A significant tax consequence of the scheme is the availability of demerger roll-over relief under Division 125 of the ITAA 1997. Broadly, a TGP shareholder can choose roll-over relief to disregard a capital gain made under the demerger. There are special rules for calculating the cost base and reduced cost base of the TGP and Kogi Iron shares for a TGP shareholder whether or not they choose roll-over relief.

Conditions for demerger roll-over relief

54. Subsection 125-55(1) of the ITAA 1997 provides that roll-over relief may be chosen if, at the time of the scheme:

- a shareholder owns a share in a company – this requirement is satisfied as participating shareholders own shares in TGP
- the company is the head entity of a demerger group – this requirement is satisfied as TGP is the head company of a demerger group
- a demerger happens to the demerger group – this requirement is satisfied as a demerger happened to the TGP 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 – this requirement is satisfied because CGT event G1 happened to the TGP shares (see paragraphs 37 and 38 of this Ruling) and TGP shareholders received Kogi Iron shares only under the demerger.

55. Under the scheme, the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 were satisfied. The Ruling section provides a detailed explanation of the Commissioner's decision. Therefore, no further explanation is warranted.

Dividend

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

57. 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.

58. '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.

59. 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.

60. In the circumstances of this demerger, TGP debited a capital reduction amount to its 'share capital account' as that term is defined in section 975-300 of the ITAA 1997. As that account was not tainted this amount is 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.

61. The total of the market value of the Kogi Iron shares was debited to TGP's share capital account. Therefore, there is no demerger dividend with respect to this demerger.

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

63. Subsection 45B(2) of the ITAA 1936 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.

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64. 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 a TGP shareholder to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

65. 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 applies 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 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

- ITAA 1936 45B(3)(b)
- ITAA 1936 45BA
- ITAA 1936 45C
- ITAA 1997
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 109-5
- ITAA 1997 109-5(2)
- 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 125-80(1)
- ITAA 1997 125-80(2)
- ITAA 1997 125-80(3)
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- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-20
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- TAA 1953

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 44(2)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(3)(a)

ATO references

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