


CR 2018/18 - Income tax: demerger of Instreet Investment Australia Limited by Instreet Investment Limited

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Class Ruling

Income tax: demerger of Instreet Investment Australia Limited by Instreet Investment 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.

Summary – 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 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 115-30 of the 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 holders of ordinary shares in Instreet Investment Limited (Instreet) who:
- were listed on the share register of Instreet as at the Record Date (26 February 2018) for the demerger of ordinary shares in Instreet Investment Australia Limited (Instreet Australia)
 - did not hold their ordinary shares in Instreet as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1)) on the Record Date – that is, they held their shares on capital account
 - are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their ordinary shares in Instreet.
- (**Note:** Division 230 will generally not apply to individuals, unless they have made an election for the Division to apply to them.)
4. In this Ruling, a person belonging to this class of entities is referred to as an 'Instreet 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 29 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 2017 to 30 June 2018. The Ruling continues to apply after 30 June 2018 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.

10. The scheme that is the subject of this Ruling involves the demerger of Instreet Australia and its controlled entities by Instreet.

Instreet

11. Instreet is an Australian resident public company which was incorporated on 13 December 2007. Its shares are not listed on any securities exchange. Instreet has 82 shareholders, all of whom are residents of Australia.

12. Instreet provides investment products and financial services to retail clients and financial advisers. Instreet currently has approximately \$500 million in assets under management.

13. Immediately before the demerger, Instreet had 2,486,378 fully paid ordinary shares on issue.

14. There were no other ownership interests (as defined in subsection 125-60(1)) in Instreet immediately before the demerger.

15. Instreet's share register, as at 26 February 2018 shows that no company has a more than 20% ownership of Instreet.

Instreet Australia

16. Instreet Australia is an Australian resident company. It was incorporated on 14 November 2017. Immediately before the demerger, all of the ordinary shares in Instreet Australia were owned by Instreet.

17. There were no other ownership interests (as defined in subsection 125-60(1)) in Instreet Australia immediately before the demerger.

18. Immediately before the demerger, Instreet Australia owns shares in various financial services companies whose activities are distinct and have different capital needs and operational features from the other businesses carried on by its parent company, Instreet.

The demerger of Instreet Australia ordinary shares

19. To effect the demerger by Instreet of Instreet Australia ordinary shares, the shareholders of Instreet voted at a meeting on 19 February 2018 to approve an ordinary resolution under section 256C of the *Corporations Act 2001* to reduce the share capital of Instreet by \$500,000 (the capital reduction amount). This amount was debited to the share capital account of Instreet.

20. The capital reduction amount equates to approximately 20 cents per Instreet ordinary share.

21. The payment of the capital reduction amount was satisfied by an *in specie* distribution to the shareholders of Instreet of 2,486,378 ordinary shares in Instreet Australia held by Instreet. The shares in Instreet Australia were transferred to the shareholders of Instreet on a pro rata basis on 26 February 2018. The shareholders of Instreet received one Instreet Australia ordinary share for every Instreet ordinary share they held at the Record Date for the demerger (26 February 2018). As a result of the demerger, the shareholders of Instreet will own shares in both Instreet and Instreet Australia.

Accounting treatment

22. The directors have valued Instreet Australia (with its controlled entities) just before the demerger at \$1,033,810.

23. Instreet, on a stand-alone basis, accounted for the distribution of Instreet Australia ordinary shares that effected the demerger by debiting its share capital account by the capital reduction amount.

24. The difference between the capital reduction amount and the fair value of the distribution to shareholders was debited to a reserve which is not sourced from Instreet's share capital account and be represented as a dividend to Instreet shareholders in accordance with accounting standards.

25. Instreet, recorded the following journal entries:

| | | |
|-------------------------------------|-----------|-----------|
| DR Share Capital | \$500,000 | |
| DR Reserve | \$533,810 | |
| CR Investment in Instreet Australia | | \$856,776 |
| CR Gain on sale | | \$177,034 |

Reasons for the demerger

26. By separating Instreet Australia from Instreet, the Board of Directors of Instreet intends to:

- enhance the capacity to raise capital separately for Instreet (including a possible listing on a securities exchange)

- allow Instreet and Instreet Australia to adopt different growth strategies and appeal to different investors
- allow Instreet and Instreet Australia to focus on their respective businesses.

Other matters

27. No amounts have been transferred to the share capital account (as defined in section 975-300) of Instreet from any of its other accounts. Accordingly, Instreet's share capital account is not tainted (within the meaning of Division 197).

28. Instreet did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 will not apply to any demerger dividend.

29. Just after the demerger, CGT assets owned by Instreet Australia and its demerger subsidiaries representing at least 50% by market value of all the CGT assets owned by those entities were used in carrying on a business by those entities.

Ruling

Dividend consequences

30. No part of the demerger distribution to Instreet shareholders will be assessable income of an Instreet shareholder under subsection 44(1) of the ITAA 1936.

Sections 45B, 45BA and 45C of the ITAA 1936

31. 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 the demerger benefit provided to Instreet shareholders under the demerger of Instreet Australia ordinary shares.

32. 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 Instreet shareholders under the demerger of Instreet Australia ordinary shares.

CGT consequences – Australian resident Instreet shareholders***CGT event G1***

33. CGT event G1 happened in respect of each Instreet ordinary share owned by an Instreet shareholder at the time Instreet made the payment of the capital reduction amount (satisfied by distributing the Instreet Australia ordinary shares) (section 104-135).

Capital gain

34. Instreet shareholders will make a capital gain from CGT event G1 happening if the capital reduction amount for each Instreet ordinary share (20 cents) is more than the cost base of the Instreet ordinary share. If so, the capital gain is equal to the amount of the excess and the cost base and reduced cost base of the Instreet share is reduced to nil (subsection 104-135(3)). No capital loss can be made from CGT event G1 (Note 1 to subsection 104-135(3)).

Demerger roll-over

35. Instreet shareholders can choose to obtain demerger roll-over under Division 125 (subsection 125-55(1)).

Consequences of choosing demerger roll-over

36. Instreet shareholders who choose demerger roll-over:

- will disregard a capital gain made when CGT event G1 happened under the demerger to their Instreet ordinary shares (subsection 125-80(1))
- must recalculate the first element of the cost base and reduced cost base of their Instreet ordinary shares, and calculate the first element of the cost base and reduced cost base of the Instreet Australia ordinary shares they acquired under the demerger (subsection 125-80(2)).

37. The first element of the cost base and reduced cost base of each Instreet ordinary share and Instreet Australia ordinary share is worked out by:

- taking the total of the cost bases of the Instreet ordinary shares just before the demerger
- apportioning that total between the Instreet ordinary shares and the Instreet Australia ordinary shares acquired under the demerger.

38. The apportionment of this total is done on a reasonable basis having regard to the market values (just after the demerger) of the Instreet ordinary shares and Instreet Australia ordinary shares, or a reasonable approximation of those market values (subsections 125-80(2) and 125-80(3)).

39. Based on the directors valuations of the respective businesses just before the demerger, a reasonable apportionment is to:

- attribute 95.8% of the total of the cost bases of the Instreet ordinary shares just before the demerger to the Instreet ordinary shares

- attribute 4.2% of the total of the cost bases of the Instreet ordinary shares just before the demerger to the Instreet Australia ordinary shares.

Consequences of not choosing demerger roll-over

40. Instreet shareholders who do not choose demerger roll-over:

- cannot disregard a capital gain made when CGT event G1 happened under the demerger to their Instreet ordinary shares
- must recalculate the first element of the cost base and reduced cost base of their Instreet ordinary shares, and calculate the first element of the cost base and reduced cost base of the Instreet Australia ordinary shares they acquired under the demerger, in the same way as described in paragraphs 37 to 39 of this Ruling (subsections 125-85(1) and (2)).

Acquisition date of the Instreet Australia ordinary shares for the purpose of making a discount capital gain

41. For the purpose of determining eligibility to make a future discount capital gain from an Instreet Australia ordinary share, an Instreet Australia ordinary share acquired by an Instreet shareholder under the demerger will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding Instreet ordinary shares (item 2 of the table in subsection 115-30(1)). This will be the case whether or not the Instreet shareholder chooses demerger roll-over.

Commissioner of Taxation

18 April 2018

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.***

42. The income tax consequences and relevant legislative provisions concerning the scheme that is the subject of this Ruling are outlined in the Ruling part of this document.

Dividend consequences

Distribution debited to the share capital account is not a dividend

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

44. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936, and includes any distribution made by a company to any of its shareholders, whether in money or other property. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) excludes a distribution by a company to its shareholders from being a dividend where the amount of the money paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

45. The term 'share capital account' is defined in section 975-300 as an account which 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.

46. An account is not a share capital account if it is tainted (subsection 975-300(3)).

47. Instreet has advised that its share capital was not tainted immediately before the demerger.

48. The demerger of Instreet Australia was implemented by Instreet distributing property (Instreet Australia ordinary shares) to shareholders of Instreet. The amount of \$500,000 (approximating 20 cents per Instreet ordinary share) was debited against an amount standing to the credit of Instreet's share capital account.

49. As Instreet's share capital account is not tainted within the meaning of Division 197, this amount will not be a dividend as defined in subsection 6(1) of the ITAA 1936. Thus, it will not be included in the assessable income of an Instreet shareholder under subsection 44(1) of the ITAA 1936.

Balance of the distribution is a demerger dividend

50. The balance of the demerger distribution to Instreet shareholders (that is, the extent to which the value of the demerger distribution exceeds the amount debited to the share capital account of Instreet) is a dividend as defined in subsection 6(1) of the ITAA 1936 (Taxation Ruling TR 2003/8 *Income tax: distributions of property by companies to shareholders – amount to be included as an assessable dividend*). However, any such dividend will be a demerger dividend as defined in subsection 6(1) of the ITAA 1936.

51. The demerger dividend will not be included in the assessable income of Instreet shareholders under subsection 44(1) of the ITAA 1936 as a result of the operation of subsections 44(3) and 44(4) of the ITAA 1936.

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

52. Section 45B of the ITAA 1936 applies where:

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936)
- (b) under the scheme a taxpayer, who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit (paragraph 45B(2)(b) of the ITAA 1936)
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

53. The arrangement involving the distribution of Instreet Australia ordinary shares to the shareholders of Instreet constitutes a scheme for the purposes of section 45B of the ITAA 1936.

54. The phrase 'provided with a demerger benefit' is defined in subsection 45B(4) of the ITAA 1936 and includes a company providing a person with ownership interests (such as shares) in that or another company. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936 and includes the provision of ownership interests (such as shares) in a company to a person. The distribution of Instreet Australia ordinary shares to the shareholders of Instreet means that Instreet shareholders were provided with a demerger benefit and were provided with a capital benefit.

55. The Commissioner considers that at least some Instreet shareholders obtained a tax benefit (within the meaning given by subsection 45B(9) of the ITAA 1936) under the scheme.

56. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the relevant circumstances (as outlined in subsection 45B(8) of the ITAA 1936) of the scheme to determine whether it could be concluded that entities that entered into or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose) of enabling the relevant taxpayer (Instreet shareholders) to obtain a tax benefit. Having regard to the relevant circumstances as outlined in subsection 45B(8), the Commissioner has formed the view that such a purpose did not exist.

57. Accordingly, section 45B of the ITAA 1936 does not apply to the scheme and 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 the demerger benefit provided to Instreet shareholders under the demerger of Instreet Australia ordinary shares
- 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 Instreet shareholders under the demerger of Instreet Australia ordinary shares.

CGT consequences – the demerger of Instreet Australia ordinary shares

58. The demerger roll-over provisions in Division 125 contain a number of conditions for eligibility to choose the roll-over. The main conditions that are relevant to the demerger of Instreet Australia ordinary shares by Instreet are:

- (a) an entity owns a share in a company (the original interest)
- (b) the company is the head entity of a demerger group
- (c) a demerger happens to the demerger group
- (d) under the demerger, a CGT event happens to the original interest and the entity acquires a new interest in the demerged entity (which must be a company) only because they own the original interest, and acquires nothing else
- (e) the entity owning the original interest must acquire, under the demerger, the same proportion of new interests in the demerged entity as they owned in the head entity just before the demerger.

59. The conditions for choosing demerger roll-over under Division 125 were satisfied in respect of the demerger of Instreet Australia ordinary shares. Accordingly, the demerger concessions in Division 125 are available to Australian resident Instreet shareholders in respect of the demerger of Instreet Australia ordinary shares.

Appendix 2 – Detailed contents list

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| <i>Previous draft:</i> | - ITAA 1936 45BA |
| Not previously issued as a draft | - ITAA 1936 45C |
| | - ITAA 1997 |
| <i>Related Rulings/Determinations:</i> | - ITAA 1997 104-135 |
| TR 2003/8; TR 2006/10 | - ITAA 1997 104-135(3) |
| | - ITAA 1997 115-30 |
| <i>Legislative references:</i> | - ITAA 1997 115-30(1) |
| - ITAA 1936 | - ITAA 1997 Div 125 |
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| - ITAA 1936 45B(3)(a) | - ITAA 1997 975-300(3) |
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| - ITAA 1936 45B(4) | - ITAA 1997 995-1(1) |
| - ITAA 1936 45B(5) | - TAA 1953 |
| - ITAA 1936 45B(8) | - Corporations Act 2001 |
| - ITAA 1936 45B(9) | - Corporations Act 2001 256C |

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