CR 2013/8 - Income tax: demerger of Enterprise Uranium Ltd by Enterprise Metals Limited

Class Ruling

Income tax: demerger of Enterprise Uranium Ltd by Enterprise Metals Limited

Contents Para

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 Enterprise Metals Limited (ENT) who:

(a) were listed on the share register of ENT as at the Record Date (23 October 2012);

(b) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Record Date;

(c) held their ENT 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 ENT 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.)

In this Ruling, a person belonging to this class of entities is referred to as an 'ENT 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 33 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.

Date of effect

8. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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 29 August 2012, ENT announced to the Australian Securities Exchange (ASX) its intention to demerge its uranium assets, to be held in Enterprise Uranium Limited (ENU).

11. On 15 October 2012 ENT shareholders approved the demerger of ENU by ENT. The demerger was implemented on 30 October 2012.

Relevant entities

Enterprise Metals Limited

12. ENT is an Australian minerals exploration company which, prior to the demerger, held a portfolio of several uranium exploration projects in Western Australia (the uranium assets). ENT also has interests in several base metals and iron ore projects located in Western Australia.

13. ENT was incorporated in January 2007 and is listed on the ASX.

14. As at 4 October 2012, ENT had on issue:

- 213,220,776 fully paid ordinary shares; and
- 62,325,806 unlisted options.

15. There were no other ownership interests in ENT just before the demerger.

16. The unlisted options have been valued at an amount that represents less than 10% of the total ownership interests in ENT.

17. Sinotech (Hong Kong) Corporation Limited owned more than 20% of the ownership interests in ENT at the time of the demerger. ENT chose under subsection 125-65(5) of the ITAA 1997 that Sinotech (Hong Kong) Corporation Limited be excluded from the demerger group.

Enterprise Uranium Ltd

18. ENU was incorporated in Australia in August 2012.

19. Following the demerger, ENU's primary focus will be the continued exploration and development of the uranium assets.

20. Immediately prior to the demerger, ENU had 42,644,155 ordinary shares on issue, all of which were wholly owned by ENT.

Pre-demerger transactions

21. Prior to the demerger, ENT and its subsidiaries entered into a sale agreement with ENU for the assignment to ENU of the uranium assets comprising tenements and tenement applications prospective for uranium. Total consideration for the transfer was satisfied by the issue of 42,644,154 ENU shares to ENT.

The demerger

22. On 30 October 2012 ENT undertook a demerger by distributing all of the 42,644,155 ordinary shares that it held in ENU to its shareholders. Owners of ENT ordinary shares received 1 ENU share for every 5 ENT shares they held on the record date.

23. The demerger was undertaken by way of a distribution of share capital and profits of ENT, satisfied by the *in specie* distribution of ENU ordinary shares. The ENT ordinary shareholders received a distribution of share capital of approximately $2.2 million (or $0.01 per ordinary ENT share) (the capital reduction amount). ENT recorded a distribution of profits of approximately $3.7 million (or $0.017 per ordinary ENT share).

24. In accordance with their terms of issue and under ASX Listing Rules, the exercise price of the unlisted options was adjusted taking into account the amount of capital returned by ENT to shareholders in respect of each share.

25. Following the demerger it is expected that ENU will undertake an initial public offer and list on the ASX.

Overseas shareholders

26. ENU shares were not issued to certain shareholders of ENT whose address was in a place outside Australia (overseas shareholders). The ENU shares to which the overseas shareholders would have been entitled were instead sold through a share sale facility with the net proceeds paid to the relevant overseas shareholder.

Accounting for the demerger

27. ENT accounted for the distribution that effected the demerger by debiting its share capital account by the capital reduction amount, $2.2 million, determined by reference to the amount of ENT's direct investment in the uranium assets being demerged.

28. The dividend amount of $3.7 million equalled the difference between the market value of ENU at the time of the demerger and the capital reduction amount. This amount was debited to ENT's retained earnings account.

Reasons for the demerger

29. ENT's primary purpose in undertaking the demerger was to separate its uranium assets from its other exploration assets. Specifically the demerger was undertaken to achieve the following commercial objectives:

- create a uranium-centric entity with its own Board and management team;
- provide separate funding channels for the uranium interests, thereby allowing ENT to conserve its cash resources for undertaking exploration activities connected with its retained portfolio of mining interests;
- improve overall shareholder value by allowing a proper recognition of the value of the uranium assets portfolio;
- provide a share spread to assist in the ASX listing of ENU, which will be an essential element in raising further capital; and
- provide shareholders with the flexibility to choose to invest in one or both of the businesses.

Other matters

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

31. ENT confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997 at the demerger implementation date.

32. ENT did not make an election under subsection 44(2) of the ITAA 1936 that subsections 44(3) and 44(4) of the ITAA 1936 do not apply to the demerger dividend.

33. ENT has never paid a dividend to its shareholders.

Ruling

Capital gains tax

CGT event G1

34. CGT event G1 happened in relation to each ENT share owned by an ENT shareholder at the time ENT made the payment of the capital reduction amount under the demerger (section 104-135 of the ITAA 1997).

35. An ENT shareholder made a capital gain when CGT event G1 happened if the capital reduction amount received for each ENT 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 when CGT event G1 happens (subsection 104-135(3) of the ITAA 1997).

Demerger roll-over

36. ENT and its subsidiary ENU are part of a demerger group under subsection 125-65(1) of the ITAA 1997.

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

38. An ENT shareholder can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997.

CGT consequences of choosing roll-over

39. An ENT shareholder who chooses demerger roll-over relief can disregard any capital gain made when CGT event G1 happened to their ENT shares under the demerger (subsection 125-80(1) of the ITAA 1997).

40. If an ENT shareholder chooses roll-over relief, they must also recalculate the cost base and reduced cost base of their ENT shares and calculate the cost base and reduced cost base of their ENU shares.

41. The first element of the cost base and reduced cost base of each ENT share and corresponding ENU share received under the demerger is worked out as follows:

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

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

- attribute 86.66% of the summed cost base to the ENT shares; and
- attribute 13.34% of the summed cost base to the ENU shares.

ENT shareholders who do not choose roll-over

43. An ENT 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 ENT shares under the demerger; and
- the first element of the cost base and reduced cost base of each ENT share and the corresponding ENU share is calculated in the same manner as if they had chosen demerger roll-over relief (see paragraphs 41 and 42 of this Ruling (subsections 125-85(1) and 125-85(2) of the ITAA 1997).

Acquisition date of ENU shares

44. For the purpose of determining eligibility for a discount capital gain, the ENU shares received by an ENT shareholder will be taken to have been acquired on the date the shareholder acquired, for CGT purposes, the corresponding ENT 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.

45. For all other CGT purposes, an ENT shareholder acquired their ENU shares on the date that the ENU shares were transferred to them by ENT, being the demerger implementation date (subsection 109-5(2) of the ITAA 1997).

Dividend

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

47. The demerger dividend is neither assessable income nor exempt income of an ENT shareholder (subsections 44(3) and 44(4) of the ITAA 1936).

48. As the capital reduction amount was debited to ENT's 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 of the ITAA 1936

49. 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 an ENT shareholder under the demerger.

50. 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 an ENT shareholder under the demerger.

Commissioner of Taxation
30 January 2013

Appendix 1 – Explanation

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

51. A significant tax consequence of the scheme is the availability of demerger roll-over relief under Division 125 of the ITAA 1997. Broadly, an ENT 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 ENT and ENU shares for an ENT shareholder whether or not they choose roll-over relief.

Conditions for demerger roll-over relief

52. 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 owned shares in ENT;
- the company is the head entity of a demerger group – this requirement is satisfied as ENT was the head company of a demerger group;
- a demerger happens to the demerger group – this requirement is satisfied as a demerger happened to the ENT 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 ENT shares (see paragraphs 34 and 35 of this Ruling) and ENT shareholders received ENU shares only under the demerger.

53. 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 necessary other than in respect of one aspect of the conditions for roll-over. The relevant issue concerns the treatment of 'adjusting instruments' in determining whether a demerger happens to a demerger group. This matter is explained at paragraphs 54 to 57 of this Ruling.

Adjusting instruments

54. 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.

55. The options are ownership interests for the purposes of this test. However, section 125-75 of the ITAA 1997 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) of the ITAA 1997).

56. In determining whether the 10% threshold test is met, adjusting instruments can be measured by reference to either their number or market value. Although the ENT options represented over 10% by number of the total ownership interests in ENT, they represented less than 10% by value. Further, the exercise price of the options was appropriately adjusted taking into account the value of the demerger distribution.

57. Accordingly, the ENT options can be disregarded for the purposes of the proportion test.

Dividend

58. 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.

59. 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.

60. '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.

61. 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.

62. In the circumstances of this demerger, ENT debited the 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.

63. However, ENT shareholders received a dividend to the extent that the market value of the ENU shares distributed under the demerger exceeded the amount debited against the share capital account (see Taxation Ruling TR 2003/8).

64. This dividend is neither an assessable income nor an exempt income amount (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 did 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.

65. In the demerger of ENU by ENT, each of the conditions in paragraph 64 of this Ruling was satisfied. Therefore, any dividend received by ENT shareholders under the demerger is neither assessable income nor exempt income.

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

66. 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.

67. 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 an ENT shareholder to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

68. 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

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2003/8
TR 2006/10

Subject references:

- capital benefit
- capital gains
- CGT capital proceeds
- CGT events G1-G3 – shares
- cost base adjustments
- demerger
- demerger dividend
- demerger roll-over
- exception to proportionate test for adjusting instruments
- return of capital on shares

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 44(2)
- ITAA 1936 44(3)
- ITAA 1936 44(4)
- ITAA 1936 44(5)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(3)(a)
- 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(2)
- ITAA 1997 115-30(1)
- ITAA 1997 Div 125
- ITAA 1997 125-55(1)
- ITAA 1997 125-65(1)
- ITAA 1997 125-65(5)
- ITAA 1997 125-70
- ITAA 1997 125-70(2)
- ITAA 1997 125-75
- ITAA 1997 125-75(4)
- ITAA 1997 125-75(5)
- ITAA 1997 125-80(1)
- ITAA 1997 125-80(2)
- ITAA 1997 125-80(3)
- ITAA 1997 125-85(1)
- ITAA 1997 125-85(2)
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- TAA 1953
- Copyright Act 1968

ATO references

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