ASX ANNOUNCEMENT

FOR IMMEDIATE RELEASE TO THE MARKET

PPK Group Limited – ASX Code: PPK

Thursday 5 May 2022

Demerger tax relief

PPK Group Limited (ASX Code: PPK) is pleased to provide additional information to shareholders concerning the likely tax treatment of the proposed demerger.

As set out in Schedule 3 of the Notice of Meeting sent to shareholders on 29 April 2022, the Company has received information from its tax adviser that the proposed transaction should qualify for demerger tax relief.

A copy of that letter is enclosed with this announcement.

This announcement has been made and authorised by the PPK Group Board.

For further information contact:

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The Board of Directors
PPK Group Limited
Level 27
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BRISBANE QLD 4000

20 April 2022

PPK Group – Demerger of PPK Mining Equipment Group Ltd

Dear Sirs

We refer to your request for advice in relation to the Australian tax implications arising from the proposed demerger of PPK Mining Equipment Group Ltd ("PPKMEG") by PPK Group Ltd ("PPK").

All legislative references relate to the *Income Tax Assessment Act 1997* ("the 1997 Act") unless stated otherwise.

Scope of Work

Our advice has been limited to the Australian income tax implications in relation to the following:

- whether the in-specie distribution of PPKMEG shares to PPK shareholders qualifies for demerger roll-over relief under Division 125 ('the demerger roll-over provisions");
- a summary of the Australian income tax outcome's arising from the in-specie distribution of PPKMEG shares to PPK shareholders in the context of the demerger roll-over provisions; and
- whether the Commissioner should apply the integrity provisions and make a determination under section 45B of the ITAA 1936.

Our opinion is based on the Australian income tax legislation, applicable case law, regulations and published rulings, determinations, and statement of administrative practice of the ATO as at the date of this letter.

The law, regulations, the tax authorities' interpretation, and administrative practices are subject to change. The policies and practices prevailing in the future when the transactions are reviewed by the tax authorities may also differ from those relied upon for the purposes of this letter. Should the relevant policies and practices change, our opinion may change as well. We will not be responsible for updating the information herein, unless we are specifically requested to do so under a separate engagement.

We, Ernst & Young, consider the Australian tax considerations in this letter represent the material Australian tax considerations to PPK and its shareholders in accordance with the relevant Australian tax laws enacted as at the date of this letter. Whilst the Australian tax considerations in this letter do not claim to describe all possible Australian income tax consequences to PPK and its shareholders, we are of the opinion it provides a fair representation of the matters we consider are the material Australian tax consequences.

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Our advice is based on the background facts, assumptions and documents listed in Appendix A. Should any of the facts or assumptions be incomplete or incorrect, please inform us as soon as possible as this may affect the outcome of our advice.

Executive Summary

Set out below is a summary of our analysis of the income tax implications in respect of the matters outlined in this letter, based on the factual background outlined in Appendix A and our detailed analysis in Appendix B.

- The proposed demerger should satisfy the demerger roll-over provisions in Division 125.
- PPK may realise a capital gain on the in-specie distribution of the PPKMEG shares to its shareholders. In these circumstances the capital gain should be disregarded under the demerger roll-over provisions.
- The PPK shareholders, who received PPKMEG shares as part of the in-specie distribution, should be able to choose rollover relief to disregard any capital gain applicable on their receipt of the PPKMEG shares.
- If the PPK shareholders choose to apply roll-over relief, the proposed demerger should have the following tax outcomes (refer to Sections 2.1. and 2.2 of Appendix B for more detailed comments):
  - to the extent the distribution of PPKMEG shares is treated as a dividend, the PPK shareholders should not include this amount in their assessable income (i.e. it constitutes non-assessable non-exempt income for tax purposes) and
  - to the extent the distribution of PPKMEG shares is treated as a capital return, the PPK shareholders should not reduce the CGT cost base/reduced cost base ("CGT cost base") of their PPK shares. Instead they should allocate their PPK share's CGT cost base between the PPK and PPKMEG shares on a basis which takes into account the relative market values of each share parcel just after the demerger.
- Foreign shareholders will have their PPKMEG shares sold under a sale facility and the following tax outcomes should apply:
  - a capital gain or loss should not arise unless the foreign shareholder holds their PPK shares through an Australian permanent establishment and/or the foreign shareholder is an individual and elected to treat their PPK shares as taxable Australian property when they ceased to be an Australian tax resident.
  - to the extent the distribution of PPKMEG shares is treated as a dividend, the dividend should not be assessable in Australia and also not subject to dividend withholding tax.

  We have not commented on the tax implications, if any, that may arise outside Australia.
- The Commissioner should not make a determination under section 45B ITAA 1936 that section 45BA ITAA 1936 applies to a demerger benefit, or that section 45C ITAA 1936 applies to a capital benefit. It is our view that the objective purpose of the proposed demerger is to separate PPK's mining equipment and technology businesses for commercial reasons. Additionally, the allocation

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between the capital return and dividend component should be accepted as reasonable and consistent with the Commissioner's preferred methodology in Practice Statement Law Administration PS LA 2005/21.

Please note our comments regarding PPK shareholders assumes they are Australian tax residents, do not hold their PPK shares as revenue assets or trading stock, are not subject to Australia's TOFA provisions in Division 230 and were not acquired under an employee share scheme.

* * * * *

Please call me on (07) 3243 3691 if you have any questions or would like to discuss the letter's contents.

Yours sincerely

Michael Hennessey
Partner

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Appendix A

Confirmed Factual Background

Our advice is based on the following facts and assumptions listed below. If any of this background information is incorrect or incomplete, please advise us as it may affect the accuracy of the advice set out in this letter. We note PPK management have reviewed this information and have confirmed it is factually accurate.

The background information relied on has been summarised under the following items:

- Historical background facts;
- Proposed Demerger steps; and
- Commercial rationale for the Demerger.

1. Historical Background Facts

- PPK is a company incorporated in Australia and was listed on the Australian Securities Exchange ("ASX") on 21 December 1994. The company is traded on the ASX under the code "PPK". At market close on 19 April 2022, the shares last traded at $4.01 each.
- PPK is the head company of an Australian income tax consolidated group (**"**PPK TCG**"**) which was formed on 1 July 2003.
- PPK's share capital consists only of ordinary class shares. At 19 April 2022, PPK had 89.29m fully paid ordinary shares on issue.
- PPK's shareholders are a mix of individuals, companies, superannuation funds and institutional investors.
- There are no shareholders who hold pre-CGT shares in PPK.
- PPK has an employee share scheme and selected individuals hold Performance Rights, which can be converted to PPK shares on a one for one basis subject to certain conditions being satisfied.
- At 16 February 2022 and based on available information, it is expected that approximately 0.64% of PPK's shareholders are foreign residents for Australian tax purposes.
- The account called "contributed equity" in PPK's 30 June 2021 financial statements is PPK's share capital account. Based on a separate review of the transactions and arrangements involving PPK's share capital account we have concluded that the share capital account of PPK should not be tainted for tax purposes.
- The PPK TCG currently has the following two principal business activities:
    - The technology business ("the Technology Business") focusing on the development and commercialisation of new technologies including;
        - manufacturing high-grade boron nitride nanotubes ("BNNT");
        - the supply to select industries to further research and development into the blending/infusing of BNNT into conventional materials;

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- investment in and enhancement of selected BNNT product applications; and
- investing in new technologies.

- The mining equipment business which involves the design, manufacture, service, support and distribution of CoalTram and other underground diesel vehicles, alternators, electrical equipment, drilling and bolting equipment and mining consumables and the hire of underground coal mining equipment ("the Mining Equipment Business").

- PPKMEG is a wholly owned subsidiary of PPK. The Mining Equipment Business assets are held by PPKMEG and its wholly owned subsidiaries (collectively referred to as the "PPKMEG Group").
- The PPKMEG Group acquired the assets and businesses that substantially comprise the Mining Equipment Business in March 2014. Since that date PPKMEG has been a wholly owned subsidiary of PPK.
- Since PPKMEG was acquired, the PPK Group has made several smaller share and business acquisitions to strengthen and consolidate its Mining Equipment Business.
- So that all of the Mining Equipment Business assets were held by the PPKMEG Group, certain smaller assets and shares were transferred to the group including, amongst other assets, the York Group Pty Ltd shares and the property located in Mt Thorley (i.e. market value approximately $1.5m).
- On 27 August 2020 PPK released its 2020 Annual Report to Shareholders and announced that it was reviewing its mining business position within PPK as it is believed a separation of this business from its BNNT commercialisation activities would maximise PPK's shareholder value.
- During the second half of the 30 June 2021 income year, PPK considered distributing the PPKMEG shares to its shareholders and listing PPKMEG. In respect to this proposal, EY conducted a Class Ruling application process ("CR Application") with the ATO (i.e. covering the Australian tax treatment of the proposed demerger).
- The ATO reviewed the CR Application and, amongst other things, emailed various questions regarding the proposed demerger. After EY replied to these questions and provided updated versions of the CR Application, EY formed the view that the ATO would likely issue a favourable response to the CR Application.
- The ATO specifically commented on the methodology used to allocate the value of the PPKMEG shares between the dividend and capital components ("dividend/capital split") for tax purposes and advised that the "relative market value" approach originally relied on in the CR Application was not the ATO's preferred methodology. Instead the ATO recommended determining the dividend/capital split based on the amount of capital invested in the demerged entity (i.e. PPKMEG). For the following reasons it is our view that the $13.49m capital component of the PPKMEG share in-specie distribution (i.e. refer to our comments below) is consistent with the ATO's expectations:
  - at 30 June 2018, the PPK group's activities were limited to the Mining Equipment Business;
  - the PPK group's contributed capital and retained losses at 30 June 2018 were $34.15m and $18.66m respectively. Accordingly, at 30 June 2018, the PPK Group's available share capital that was invested in the Mining Equipment Business was $15.49m (i.e. $34.15m of share capital less $18.66m of retained losses);
  - after 30 June 2018, PPK had a number of capital raisings and increased its share capital. The funds from these capital raisings were used solely in the development and commercialisation of PPK's Technology Business and have been excluded from the dividend/capital split calculation; and

- PPKMEG will owe PPK $2.0m after it has been demerged from the PPK group, As this economic interest will survive the Demerger, the amount of capital available to be returned to the PPK shareholder should be reduced by the $2.0m loan.

- The CR Application was withdrawn on 23 May 2021 after PPK decided to investigate opportunities to sell the Mining Equipment Business to an unrelated party.
- On 31 August 2021, PPK released its 2021 Annual Report to Shareholders and advised the market of the Directors' decision to demerge PPKMEG with the intention to either list it as a separate entity on the Australian Securities Exchange (i.e. as a separate business from PPK) or to sell all of its PPKMEG shares to another entity.
- Throughout this time, PPK has held discussions with a number of potential purchasers for the sale of its Mining Equipment business. However, none of the sale discussions progressed to a written offer and PPK management determined that the sale of the Mining Equipment Business in the current market is not a commercially viable option.
- PPK is currently negotiating a binding conditional agreement to acquire certain assets from another leading mining services company ("the Asset Acquisition"). If this transaction is signed and completes, it would strengthen PPKMEG's original equipment manufacturing position in New South Wales, as well as providing a strategic foothold in Queensland. As part of this transaction, PPKMEG will also offer employment to certain employees of that mining services company. The purchase price and related costs for the acquisition of those assets is expected to be between $9-10m and would be 100% debt funded by PPKMEG. PPKMEG would also be liable for certain accruals and entitlements of those employees accepting employment with PPKMEG and the potential liability for this is currently estimated to be slightly greater than $1m. Accordingly, PPK management have advised that the Asset Acquisition should only result in a nominal increase, if any, to PPKMEG's market value.
- PPK engaged 22 Capital Advisory Pty Ltd ("22CAPL") to value the PPKMEG shares at 28 February 2022. 22 CAPL issued their report on 31 March 2022 ('the Report") and determined PPKMEG's equity value to be $18.0m based on their analysis in the Report. The valuation took into account the full capitalisation of the PPKMEG loan to discussed below. Now it is proposed $2.0m of this loan will remain outstanding and the adjusted value of the PPKMEG shares is $16.0m.
- 22CAPL's market valuation of PPKMEG did not consider the Asset Acquisition when valuing PPKME, which will be wholly funded by third party debt. We have been advised by PPK management that the acquisition should not impact on the market value of PPKMEG.

2. Proposed Demerger Steps

- PPK has decided it will distribute all of its PPKMEG shares to its shareholders ("the Demerger").
- We have reviewed the draft Notice of Extraordinary General Meeting ("the EGM Notice") which sets out the background to the proposed demerger.
- The Demerger will be comprised of the following steps:
  - The assets comprising the Mining Equipment Business are principally held by PPKMEG or one of its wholly owned subsidiaries.
  - PPKMEG will pass resolutions to become a public company in accordance with the requirements of the *Corporations Act 2001*.

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- Historically, the PPKMEG Group has been debt funded over time by certain PPKMEG Group members. PPK will subscribe for PPKMEG shares :
  - to equalise the number of PPKMEG and PPK shares on issue so that PPK can demerge PPKMEG and distribute to its shareholders one PPKMEG share for each PPK share they own; and
  - PPKMEG can financially separate from the PPK TCG by substantially settling its intercompany payable balances before the group is demerged.
- The capitalisation of PPKMEG and settlement of the intercompany loan balances will take place between members of the PPK TCG.
- PPK will subscribe for 89,231,601 shares in PPKMEG for $18.36m so the number of PPKMEG's shares is identical to the shares on issue by PPK (i.e. there will be 89,289,293 PPKMEG shares on issue).
- PPKMEG will use the $18.36m capital proceeds to substantially settle the net intra-group loans owed by the PPKMEG Group to post PPK TCG members and PPKMEG will be left with a $2.0m loan payable to PPK.
- PPK will transfer the PPKMEG shares to the company's shareholders in the form of an in-specie distribution of the PPKMEG shares.

- The distribution of the PPKMEG shares will be comprised of :
  - a $13.49m return of capital ("Return of Capital"); and
  - a $2.51m special dividend ("Special Dividend").
- The $13.49m Return of Capital will be debited to PPK's share capital account.
- The $13.49m return of capital represents PPK's available share capital invested in the PPKMEG Group (i.e. after taking into consideration PPK's $34.15m of contributed capital and $18.66m retained losses at 30 June 2018) less the $2.0m owed by PPMKEG to PPK (i.e, refer to our comments above).
- The $2.51m debit to retained earnings will be treated as a dividend for accounting and tax purposes.
- Only PPK shareholders with a registered address in Australian and New Zealand will receive shares in PPKMEG.
- PPK shareholders with a registered address outside Australia and New Zealand will not be legally entitled to participate in the Demerger ("Ineligible Foreign Shareholders").
- Accordingly, the PPKMEG shares that are distributed to the Ineligible Foreign Shareholders and would otherwise have been held by each Foreign Shareholder will be sold by a sales agent appointed by the Company. All proceeds of the sale of such shares will be paid to each Foreign Shareholder and the Company will cover the respective brokerage costs. At 16 February 2022, this represents approximately 0.64% of the fully paid ordinary shares on issue.
- After the Demerger, PPKMEG is expected to have $9.2m of debt (i.e. to fund the Asset Acquisition), $2.0m of debt owing to PPK (i.e. incurred in connection with the earlier financing provided by PPK) and access to a $4.0m finance facility from the NAB. PPKMEG has applied for additional funding from NAB for $4.0m for working capital purposes to support its business growth and a $4.0m lease facility to refinance its fleet of vehicles and other operating equipment

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- PPKMEG's businesses are currently supported by PPK's corporate services infrastructure including group accounting, treasury, taxation, human resources, legal, insurance administration, information management, purchasing services, payroll, and other services. There will be a transition period where PPKMEG will continue to use these PPK services and remunerate PPK on an arm's length basis. As part of the Demerger implementation, PPKMEG intends to move over time to perform these functions in-house or enter into third party contracts and arrangements appropriate for a standalone entity.
- The PPKMEG Board will initially comprise three directors: Mr Levison, who will be a Non-Executive Director and Chairman, Mr McNamara who will be an Executive Director and one further Non-Executive Director being Mr McDonald. If the proposed Transaction proceeds, Mr McNamara proposes to tender his resignation as a director of PPK to focus on PPKMEG
- PPK will not make an election under subsection 44(2) of the *Income Tax Assessment Act* 1936 so that the demerger roll-over relief is not available to the PPK shareholders in relation to the in-specie distribution of the PPKMEG shares.

3. Commercial Rationale for the Demerger

PPK currently carries out two distinct and separate businesses, these being the Mining Equipment Business and Technology Business.

PPK management is focused on the Technology Business and has made the commercial decision to demerge PPKMEG and the Mining Equipment Business it owns so that PPKMEG is a standalone public company for the following reasons:

- PPK technology focus

  PPK is now focused on the BNNT Technology and other technology ventures. PPK intends to continue to develop its high-growth technology assets and considers it critical to distance itself from the PPKMEG operations in the coal industry.

  PPK's Directors no longer consider the group's involvement with the coal industry to be consistent with PPK's focus on strategic growth opportunities in the technology sector and are concerned that continued involvement in the coal industry would limit investment in PPK and its ability to raise capital funds as certain key investors are currently restricted from investing in PPK due to their investment guidelines or aversion to the coal industry.

- Investor choice

  Separating PPK and PPKMEG will allow existing and prospective investors seeking exposure solely to PPK's Technology Business to invest directly in that business without exposure to the PPKMEG mining equipment and services business. Likewise, existing, and prospective investors seeking exposure to the PPKMEG mining equipment and services business will be able to invest directly in PPKMEG without having exposure to PPK's Technology Business.

- Strategic focus

  PPKMEG will operate as an unlisted public company. PPKMEG aims to improve profitability and create shareholder value by leveraging the acquisition of certain assets from another leading mining services company. This transaction will strengthen PPKMEG's OEM position in New South Wales, as well as providing a strategic foothold in Queensland.

- Eligible Shareholders will retain their existing exposure to PPKMEG

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Under the Demerger, eligible PPK shareholders will have the ability to retain an ongoing exposure to PPKME, its assets and its business through a direct shareholding in PPKMEG.

- Greater flexibility in financing

  The Demerger will position PPK and PPKMEG to be able to separately fund their own operations and growth strategies in the future.

  PPK will be able to seek investment from financiers and investors, including those with a technology focus who do not wish to have exposure to the coal mining industry, including both debt and equity investors, as well as be able to more effectively use PPK shares as consideration in potential mergers, takeovers, and equity financing transactions in the technology space.

  The PPK Directors believe that PPKMEG will be in a position to more clearly articulate the merits of the PPKMEG Business as a compelling critical equipment and service provider to the underground coal industry which could prove more attractive than when integrated with the Technology Business.

- Management focus

  The separation of PPK and PPKMEG will allow each entity to better pursue the targeted strategies of its business. The PPK senior management team will be able to focus on realising the value of BNNT manufacturing and the BNNT application ventures through the execution of the strategy for that business as articulated in recent investor presentations and shareholder announcements. Similarly, PPKMEG's senior management team will focus on the continuation of improving the economic returns of its equipment and service business and creating shareholder value.

- Valuation of PPK

  Investors have indicated to PPK that they would value PPK differently if it does not have any involvement in the coal industry. The PPK Board considers that the Demerger will reduce the likelihood that PPK will trade at a price below the intrinsic value of its assets.

- Working capital

  After the Demerger, PPKMEG is expected to have $9.2m of debt (i.e. to fund the Asset Acquisition), $2.0m of debt owing to PPK (i.e. incurred in connection with the earlier financing provided by PPK) and access to a $4.0m finance facility from the NAB. PPKMEG has applied for additional funding from NAB for $4.0m for working capital purposes to support its business growth and a $4.0m lease facility to refinance its fleet of vehicles and other operating equipment. PPK will hold the remainder of the PPK group's cash and will also benefit from the financial contribution of its joint venture, subsidiaries, and associated investments.

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Appendix B

Demerger Roll-over Relief Technical Analysis

Set out below is our detailed taxation advice in relation to the following matters:

- whether the in-specie distribution of PPKMEG shares to PPK shareholders should qualify for demerger roll-over relief under Division 125;
- a summary of the Australian income tax outcome's arising from the in-specie distribution of PPKMEG shares to PPK shareholders in the context of the demerger roll-over provisions; and
- whether the Commissioner should apply the integrity provisions and make a determination under section 45B of the ITAA 1936.

We have separately considered each of the items below.

1. Demerger Roll-over Relief

The demerger roll-over provisions in Division 125 were introduced in 2002 as part of *The New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002.*
Specifically, this amending Act introduced the following:

- a Capital Gains Tax ("CGT") roll-over when a CGT event happens to original interests in a company under a demerger and new or replacement interests are received in the demerged entity; and
- an exemption for certain dividends arising under a demerger.

The Explanatory Memorandum states the following objective of these provisions at paragraph 15.5:

> *"The CGT relief and dividend exemption will facilitate the demerging of entities by ensuring that tax considerations are not an impediment to restructuring a business. These amendments are based on Recommendation 19.4 of A Tax System Redesigned, and recognise that there should be no taxing event for a restructuring that leaves members in the same economic position as they were just before the restructuring."*

For the demerger roll-over provisions to apply to the Demerger all of the conditions in subsection 125-55(1) must be satisfied.

It is our view that the Demerger should satisfy the conditions in subsection 125-55(1). To support this conclusion we have structured our analysis as follows:

- whether the Demerger should qualify as a "restructuring" of the demerger group;
- whether the PPK shareholders should receive PPKMEG shares under the Demerger and "nothing else"; and
- whether the remaining conditions in subsection 125-55(1) should be satisfied.

1.1 A restructuring of the demerger group (i.e. paragraph 125-70(1)(a))

The in-specie distribution of the PPKMEG shares to PPK shareholders should qualify as a restructuring of the demerger group for the purposes of Division 125. Therefore, this condition should be satisfied.

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The term "restructuring" is not defined in the tax legislation and the Explanatory Memorandum supporting paragraph 125-70(1)(a) provides little guidance on what is considered a "restructuring" in the context of the demerger roll-over provisions in Division 125.

The Commissioner in Tax Determination TD 2020/6 ("TD 2020/6") provided a detailed view as to what the definition of a 'restructure' is in the context of Division 125. In that ruling, he advised that that the term "restructuring" should be interpreted according to its "*… ordinary business meaning"* and may include previous or subsequent transactions in a sequence of transactions. While TD 2020/6 indicates the Commissioner will apply a broad view of what transactions comprise a restructuring, paragraphs 8 to 11 provide that even if certain steps form part of the restructuring, the demerger rollover relief in Division 125 will still be available where, amongst other things:

- there has been no change in the economic position of the owners of the original interests in the head entity (e.g. PPK) of the demerger group; and
- the transactions or steps in a restructuring are merely for the preparation of the demerged entity (e.g. PPKMEG) and do not affect either the existence, proportionality, or value of the ownership interests in the head entity of the demerger group (e.g. PPK) or the economic position of the owners of ownership interests in the head entity of the demerger group (e.g. the PPK shareholders).

The scope of the "restructure" for the purposes of Division 125 should be comprised of all transactions/arrangements listed in Section 2 of Appendix A ("the Restructuring Steps"). PPKMEG became a wholly owned subsidiary of PPK during March 2014. The Restructure Steps should include the capitalisation of the PPK loan to PPKMEG and the transfer of certain immaterial assets to the PPKMEG Group so that all the Mining Equipment Business assets are held by the PPKMEG Group. On the basis that none of the Restructuring Steps affects the economic position of the PPK shareholders we consider none of these steps should cause the Demerger to fail any of the conditions in subsection 125-55(1).

This view is supported by, Example 7 in TD 2020/6, which confirms that the preparatory steps and transactions to demerge a business from an ASX listed company will form part of the "restructuring" for Division 125 purposes. However, these steps and transactions should not cause the failure of any of the conditions in subsections 125-70(1) and (2) as they do not result in a change to the economic position of the shareholders in the ASX listed company and we consider these principles to apply equally to the Demerger.

For completeness, we have also considered the implications, if any, arising from PPKMEG's proposal to acquire the assets and business operations from another leading mining services company ("the Asset Acquisition"). Specifically, the ATO at Practice Statement Law Administration PS LA 2005/21 ("PS LA 2005/21), which deals with the application of section 45B of the ITAA 1936, indicates at Case Study 5 that activities undertaken to expand or grow a demerged entity (i.e. PPKMEG) will not preclude the restructure from qualifying as a "genuine demerger" providing demerger rollover relief was no more than an incidental purpose of the restructure.

Accordingly, it is our view the Asset Acquisition proposal should not cause the Demerger to fail any of the conditions in subsection 125-55(1). This is based on the ATO's comments in PSLA 2005/21 and, on the understanding the Asset Acquisition is an appropriate step towards consolidating PPKMEG's Mining Equipment Business and ensure PPKMEG is commercially viable and able to operate as a stand-alone business (i.e. rather than achieve demerger roll-over relief).

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1.2 Under the restructuring, a CGT event happens to an original interest owned by an entity in the head entity of the group and the entity acquires a new interest and nothing else (i.e. paragraph 125-70(1)(c)(i))

The PPK shareholders will acquire an interest in PPKMEG as a result of a CGT event (i.e. CGT event G1) and nothing else. Therefore, this condition should be satisfied.

For completeness, the Commissioner at paragraph 7 of TD 2020/6 advised that the scope of the restructure (i.e. including when it begins and ends) is also relevant to the conditions in paragraph 125-70(1)(c). However, providing any transactions or steps in a restructuring are merely to prepare for the separation of PPKMEG and do not affect the existence, proportionality, or value of the PPK shareholders' interest in PPK, then the "nothing else" condition should be satisfied. Accordingly, our comments at Section 1.1 apply equally here and we consider the steps comprising the restructuring (i.e. listed in Appendix A) should not preclude the Demerger from satisfying the condition in paragraph 125-70(1)(c)(i).

As is common practice for most demergers implemented by ASX listed companies, PPK will implement a sale facility for certain ineligible foreign resident shareholders (i.e. PPK shareholders with a registered address other than Australia and New Zealand), whereby their PPKMEG shares will be sold on market by a nominee and the foreign resident shareholders will receive the cash proceeds.

The implementation of a sale facility in these circumstances was contemplated by the legislature and references to such an arrangement was included in notes to subsections 125-70(1) and 125-70(3). Specifically, the note under subsection 125-70(1):

> *"Acquiring new interests by an owner of original interests may include the allocation of the owner's entitlement to new interests to a nominee:*
>
> - *to sell on the owner's behalf; or*
> - *to hold pending the owner being located."*

We consider the use of a sale facility for Ineligible foreign shareholders was contemplated by the legislature and is accepted by the ATO (i.e. in TD 2020/6). Accordingly, the Ineligible foreign shareholders should receive new interests in PPKMEG and nothing else for the purposes of Division 125. This is on the basis that the foreign resident shareholders will only receive PPKMEG shares from the Demerger, albeit those shares will be sold by a nominee and the foreign shareholders will receive the market value sale proceeds rather than the shares themselves.

1.3 Detailed Division 125 conditions

For the distribution of the PPKMEG shares to qualify for demerger roll-over relief it must satisfy all of relevant conditions in Division 125.

Our starting point is determining whether the Demerger has met the four conditions in the operative section (i.e. subsection 125-5(1)) and our detailed analysis is set out below.

1.3.1 You own an "ownership interest" in a company (paragraph 125-55(1)(a))

An "ownership interest" is defined in section 125-60 to include a share in a company or an option, right or similar interest issued by the company that gives the owner an entitlement to acquire a share in the company.

We consider the ordinary shares issued by PPK should be considered "ownership interests" for the purposes of section 125-60.

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1.3.2 The company is the "head entity" of a "demerger group" (paragraph 125-55(1)(b))

A "demerger group" comprises the "head entity" of the group and one or more "demerger subsidiaries". Section 125-65 sets out the meaning of the terms, "head entity", "demerger group" and "demerger subsidiary".

A company is a "head entity" of a demerger group if no other member of the group owns ownership interests in the company.

However, if the company and its demerger subsidiaries are demerger subsidiaries of another demerger group then the company is not a head entity. In this regard, a company is a "demerger subsidiary" of another company or trust that is a member of a demerger group if the other company or trust, either alone or together with other members of the group, owns, or has the right to acquire, ownership interests in the company that carry between them:

- the right to receive more than 20% of any distribution of income or capital by the company; or
- the right to exercise, or control the exercise of, more than 20% of the voting power of the company.

PPK is the head entity of a demerger group as no other member of the group holds ownership interests in PPK. PPK and PPKMEG are not demerger subsidiaries of another demerger group as no company or trust owns, or has the right to acquire, more than 20% of PPK shares. It is noted for completeness that PPK does not need to make a choice under subsection 125-65(5).

As such, the PPK demerger group should comprise PPK (as head entity of the tax consolidated group) and its wholly owned subsidiaries including PPKMEG as the demerger subsidiary.

1.3.3 A demerger happens to the demerger group (paragraph 125-55(1)(c))

A demerger happens when all of the conditions outlined in section 125-70 are present, provided the exceptions in subsections 125-70(4) and 125-70(5) do not apply. Each of the conditions and exceptions is discussed below.

1.3.3.1 There is a restructuring of the demerger group (paragraph 125-70(1)(a))

Our comments at 1.1 covered this condition.

1.3.3.2 Under the restructuring, members of the demerger group dispose of at least 80% of their total ownership interests in another member of the demerger group to owners of "original interests" in the head entity of the demerger group (subparagraph 125-70(1)(b)(i)).

PPK (i.e. the head entity of the demerger group), will dispose of 100% of the shares it owns in PPKMEG (i.e. the demerged entity) to the shareholders of PPK (i.e. owners of "original interests" in the head entity of the demerger group) so that PPK shareholders will directly own 100% of the shares in PPKMEG that PPK previously held. Accordingly, this condition should be satisfied.

1.3.3.3 Under the restructuring, a CGT event happens to an original interest owned by an entity in the head entity of the group and the entity acquires a new interest and nothing else (subparagraph 125-70(1)(c)(i))

Our comments at 1.2 covered this condition.

1.3.3.4 The acquisition by entities of new interests happens only because those entities own or owned original interests (paragraph 125-70(1)(d)).

The acquisition of shares in PPKMEG will happen only because those shareholders own ordinary shares (original interests) in PPK and will be entitled to receive ordinary shares in PPKMEG. Accordingly, this condition should be satisfied.

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1.3.3.5 The new interests acquired are ownership interests in a company if the head entity is a company (paragraph 125-70(1)(e)).

The head entity (i.e. PPK) is a company and the new interests acquired are ordinary shares (i.e. ownership interests) in PPKMEG, which is also a company. Therefore, this condition should be satisfied.

1.3.3.6 Neither the original interests nor the new interests are in a trust that is a superannuation fund (paragraph 125-70(1)(g))

Neither the original interests nor the new interests are in a trust that is a superannuation fund. Therefore, this condition should be satisfied.

1.3.3.7 The requirements of subsection 125-70(2) are met.

The requirements of subsection 125-70(2) and their application to the demerger are discussed below.

Each owner (an original owner) of original interests in the head entity of the demerger group 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 in the head entity just before the demerger (paragraph 125-70(2)(a)); 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 (paragraph 125-70(2)(b)).

In working out whether an original owner complies with the above requirements (subsection 125-70(3)):

- disregard ownership interests that are original interests the owner owns in the demerged entity: and
- an anticipated reasonable approximation of the market value of ownership interests is sufficient.

Under the Demerger each of the PPK shareholders will receive an in-specie distribution from PPK constituting one PPKMEG share for each PPK share they own. As such, they will have acquired the same proportion of shares in PPKMEG (the demerged entity) as they owned in PPK (the head entity) just before the Demerger. Accordingly, paragraph 125-70(2)(b) should be satisfied.

1.3.3.8 Exceptions to Subsection 125-70(2)

In calculating the proportion of ownership interests in the head entity and in the demerged entity for the purposes of subsection 125-70(2), there are exceptions for employee shares schemes and adjusting instruments.

Employee share scheme

In working out whether the requirements in subsection 125-70(2) are met, certain ownership interests are disregarded if, just before the demerger, those interests (taking into account either or both of their number and value) represented not more than 3% of the total ownership interests in the entity.

An ownership interest held by an entity in PPK will be disregarded if, among other things:

- the entity acquired a beneficial interest in the ownership interest under an employee share scheme; and
- either Subdivision 83A-B and subsections 83A-35(3) to (9), or Subdivision 83A-C, applies to the beneficial interest, and
- the ownership interest is not a fully-paid ordinary share.

PPK has an employee share scheme and selected individuals hold Performance Rights, which can be converted to PPK shares on a one for one basis subject to certain conditions being satisfied.

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As the Performance Rights do not constitute a fully-paid ordinary share, Subdivision 83A-C applies to the Performance Rights, and just before the Demerger these interests (taking into account both number and value) will be less than 3% of the total ownership interests in PPK. Accordingly, the value of the Performance Rights should be excluded from the calculation of the ownership interests for the purposes of subsection 125-70(2).

Adjustment Instruments

PPK has no adjusting instruments on issue.

1.3.3.9 Other exceptions to section 125-70

There is no demerger for the purposes of section 125-70 if subsections 125-70(4) or 125-70(5) apply. These exceptions to demerger rollover relief are considered below.

Off Market Buybacks (subsection 125-70(4))

There will not be a buyback of shares that is an off-market purchase for the purposes of Division 16K of Part III of the *Income Tax Assessment Act* 1936 ("ITAA 1936") and, therefore, the exception in subsection 125-70(4) does not apply.

CGT roll-over relief ("roll-over relief") available under another provision (subsection 125-70(5))

PPK shareholders who are entitled to obtain roll-over relief under another provision are not entitled to demerger relief. As PPK shareholders are not eligible to obtain roll-over under another provision for the demerger this exception does not apply.

1.3.4 Under the demerger, a CGT event happens to your original interest and you acquire a new or replacement interest (your new interest) in the demerged entity (paragraph 125-55(1)(d))

As discussed above, CGT event G1 should happen to ownership interests in PPK when the capital reduction occurs to ordinary shares held by PPK shareholders. The shareholders in PPK will then acquire a new interest in PPKMEG, which is the "demerged entity" (refer below). Therefore paragraph 125-55(1)(d) should be satisfied.

The meaning of "demerged entity" is set out at subsection 125-70(6) of the ITAA 1997 as:

- An entity that is a former member of a demerger group is a demerged entity if, under a demerger that happens to the group, ownership interests in the entity are acquired by:
  - shareholders in the head entity of the group; or
  - unitholders or holders of interests in the head entity of the group.

PPKMEG will be a demerged entity as it will be a former member of a demerger group and under the Demerger, ownership interests in PPKMEG will be acquired by shareholders in PPK (the head entity of the PPK Group).

2. Demerger roll-over relief outcomes for Australian resident PPK shareholders

As all of the conditions for demerger roll-over relief under Division 125 should be satisfied, the following tax outcomes should be available to the Australian resident shareholders if they choose to apply the demerger roll-over relief:

- concessionary CGT tax treatment in respect of the capital component of the PPKMEG share distribution; and
- the dividend component of the PPKMEG share distribution treated as non-assessable non-exempt income.

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2.1 Concessionary CGT tax treatment

The CGT consequences of choosing demerger roll-over relief for PPK's Australian resident shareholders are set out in section 125-80 and are as follows:

- Any capital gain as a result of the capital reduction comprising the receipt of new shares in PPKMEG should be disregarded (subsection 125-80(1)).
- The first element of the cost base and reduced cost base of the shares held by the shareholders in PPK and PPKMEG should equal the proportion of the cost base/reduced cost base of their original PPK shares as is reasonable having regard to the market values of the PPK shares and PPKMEG shares just after the demerger (or an anticipated approximation of those market values).
- PPK proposes that the apportionment of the cost base of the PPK shares should be based on
  - the quoted share price (Volume Weighted Average Price) for PPK for the first 5 trading days immediately after the demerger; and
  - the market value of the PPKMEG shares, which is estimated to be $16.0m for all the PPKMEG shares.
- PPKMEG shareholders should be taken to have acquired their shares at the time their relevant PPK shares were acquired. As such, shareholders that qualify for the CGT discount in Division 115 should be taken, for the purposes of the "12 month holding rule" in section 115-25, to have held their PPKMEG shares from the time when their relevant PPK shares were acquired.

The CGT consequences for PPK are set out in section 125-155 and are as follows:

- Any capital gain or loss that PPK makes by distributing the PPKMEG shares to its shareholders (i.e. CGT event A1) should be disregarded.

2.2 Tax treatment of the in-specie distribution (the demerger allocation)

The dividend component of the Demerger (i.e. $2.51m) should constitute a demerger dividend for tax purposes and should not be included in the Australian assessable income of the PPK shareholders.

All legislative references in this question relate to the Income tax Assessment Act 1936 unless otherwise stated.

2.2.1 Demerger Dividend Analysis

For the dividend component of the Demerger to constitute a demerger dividend for tax purposes and not be assessable income, the following four conditions must be satisfied:

- the dividend component must be part of a demerger allocation.
- the dividend component must satisfy the definition of a dividend for tax purposes in subsection 6(1)
- PPK does not make an election under subsection 44(2); and
- subsection 44(5) applies and at least 50% of the market value of PPKMEG Group's CGT assets are used directly or indirectly in one or more businesses carried on by a member of the group just after the Demerger.

For completeness, subsection 44(3) deems an amount that qualifies as a demerger dividend for tax purposes to not be paid out of profits and subsection 44(4) treats the amount as not assessable not exempt income (i.e. not included in the Australian assessable income of the PPK shareholder).

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We have considered each of the above conditions separately below.

2.2.1.1 Demerger Allocation

The dividend component of the Demerger should form part of a demerger allocation.

Subsection 6(1) prescribes that a "demerger allocation" means:

a) The total market value of the allocation represented by the ownership interests issued by the demerged entity in itself under a demerger to the owners of ownership interests in the head entity of the demerger group; or

b) The total market value of the allocation represented by the ownership interests disposed of by a member of a demerger group under a demerger to the owners of ownership interests in the head entity; or

c) The total of both of those market values.

Applying (b) of the above definition, the market value of the shares in PPKMEG should be a "demerger allocation".

2.2.1.2 Subsection 6(1) definition of a dividend

A dividend is defined broadly in the tax legislation and prima facie includes *"… any distribution made by a company to any of its shareholders, whether in money or other property".*

In this regard, the definition of a dividend in subsection 6(1) excludes "…
any moneys paid or credited by a company to a shareholder or any other property distributed by a company to its shareholders," where the amount of moneys 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.

Taxation Ruling TR 2003/8 indicates that the amount of a dividend in respect of a distribution of property (e.g. the distribution of PPKMEG shares to a shareholder in their capacity as a PPK shareholder) will be the money value of the property at the time it is distributed, reduced by the amount debited against the amount standing to the credit of PPK's share capital account in respect of the in-specie distribution of the PPKMEG shares.

Accordingly, the dividend component of the in-specie distribution of the PPKMEG shares should be approximately $2.51m and represent the amount of the distribution not debited against the amount standing to the credit of PPK's share capital account (i.e. $2.51m debited to PPK's retained earnings).

2.2.1.3 PPK does not make an election under subsection 44(2);

If PPK makes an election under subsection 44(2), subsections 44(3) and 44(4) will not apply and the dividend component of the Demerger will be assessable income to the PPK shareholders.

PPK has confirmed it will not make an election pursuant to subsection 44(2). As such, subsections 44(3) and 44(4) of the ITAA 1936 should apply, to the extent there was a demerger dividend and the dividend component of the in-specie distribution of the PPKMEG shares should be not assessable or exempt income, provided the requirements in subsection 44(5) are met. We have considered this separately below.

2.2.2 Majority business assets - subsection 44(5)

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Subsection 44(5) states that subsections 44(3) and 44(4) do not apply to a demerger dividend unless, just after the demerger, CGT assets owned by the demerged entity (i.e. PPKMEG) or a demerger subsidiary representing at least 50% by market value of all the CGT assets (or a reasonable approximation of market value) owned by the demerged entity and its demerger subsidiaries are used, directly or indirectly, in one or more businesses carried on by one or more of those entities.

This requirement is directed at ensuring that PPKMEG as the demerged entity is a viable, independent entity, capable of conducting business in its own right. In this regard, we confirm that just after the demerger 100% (i.e. more than 50%) of the market value of the CGT assets owned by PPKMEG should be used in the carrying on of the business of PPKMEG and we refer to our comments in Appendix A demonstrating that PPKMEG will operate a separate and viable business in its own right as a public company.

Therefore, we consider that subsections 44(3) and 44(4) should apply to the proposed demerger (to the extent there is a demerger dividend).

2.2.3 Share Tainting Rules

If a company transfers an amount to its share capital account from any other account, its share capital account may be tainted and, amongst other things, a distribution from the share capital account should be taxed in the hands of a shareholder as a dividend (i.e. as the tainted share capital account does not count as a share capital account for the purposes of the definition of a "dividend" in subsection 6(1)(d)).

Accordingly, the risk, if any, that PPK's share capital account is tainted would have implications for the allocation between the dividend and capital return components of the PPKMEG share distribution.

We have conducted a review of the transactions and arrangements involving PPK's share capital account and have confirmed that the share capital account of PPK should not be tainted for tax purposes.

3. Commissioner's Determination under section 45B of the Income Tax Assessment Act 1936 regarding the application of sections 45BA or 45C to the demerger allocation received by Participating Shareholders

All legislative references in this question relate to the Income Tax Assessment Act 1936 unless otherwise stated.

We consider the Commissioner should not make a determination under subsection 45B(3) that either sections 45BA or 45C applies as the Demerger is occurring for commercial reasons and any tax benefits that may arise are merely incidental.

Our analysis supporting this conclusion is set out below.

3.1 Determination under Section 45B

Subsection 45B(3) provides that the Commissioner may make a determination that section 45BA applies in relation to the whole, or a part, of a demerger benefit, or that section 45C applies to the whole or any part of a capital benefit.

Section 45B is an integrity measure that applies to ensure that certain amounts under a demerger are treated as an assessable unfranked dividend for income tax purposes if:

- components of a demerger allocation as between capital and profit do not reflect the circumstance of a demerger; or

- certain payments, allocations and distributions are made in substitution for dividends.

In particular, section 45B will apply where all the conditions of subsection 45B(2) are satisfied. Relevantly, this section applies if:

- there is a scheme under which a person is provided with a demerger benefit or capital benefit by a company (paragraph 45B(2)(a);
- 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)); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Where the requirements of subsection 45B(2) are met, subsection 45B(3) empowers the Commissioner to make a determination that either section 45BA applies in relation to a demerger benefit or section 45C of the ITAA 1936 applies in relation to a capital benefit, and to therefore treat all or part of the demerger allocation or the capital benefit as an assessable unfranked dividend.

3.2 Subsection 45B(2) conditions

Section 45B will apply where all the conditions of subsection 45B(2) are satisfied:

3.2.1 *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))*

A "scheme" for the purposes of section 45B is taken to have the same meaning as provided in subsection 177A(1).

A scheme is defined for this purpose in section 177A to mean:

- any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable by legal proceedings; and
- any scheme, plan, proposal, action or course of action.

The Demerger as outlined in Section 2 of Appendix A will satisfy the definition of a scheme for the purposes of this section.

3.2.2 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))

The relevant taxpayer is the taxpayer who obtains a tax benefit under the scheme within the meaning of subsection 45B(9). Under a demerger, the relevant taxpayer(s) will ordinarily be the owner(s) of ownership interests in the head entity of the demerger group, as they are provided with the demerger benefit and/or capital benefit (i.e. we have commented separately below on the nature of each of these benefits). In this instance, the relevant taxpayers would be the ordinary shareholders of PPK.

3.2.2.1 Demerger Benefit

Subsection 45B(4) provides that a person is provided with a demerger benefit if, in relation to a demerger:

> *"a) a company provides the person with ownership interests in that or another company; or*

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b) something is done in relation to an ownership interest owned by the person that has the effect of increasing the value of an ownership interest (which may or may not be the same ownership interest) owned by the person."

Under a demerger, it is expected that a person will always be provided with a demerger benefit. In this instance, PPK will provide a demerger benefit to the PPK shareholders following the in-specie distribution of the shares in PPKMEG. As such, subsection (a) should be satisfied and there should be a demerger benefit.

3.2.2.2 Capital Benefit

Subsection 45B(5) provides that a person being provided with a capital benefit is a reference to any of the following:

"a) The provision of ownership interests in a company to the person;

b) The distribution to the person of share capital or share premium;

c) Something that is done in relation to an ownership interest that has the effect of increasing the value of an ownership interest (which may or may not be the same interest) that is held by the person."

In this instance PPK shareholders will be provided with shares in PPKMEG which will be regarded in part as a return of capital of $13.49m and, therefore, there should be a capital benefit of $13.49m.

Accordingly, the demerger is a scheme under which PPK shareholders should be provided with a demerger benefit and a capital benefit by PPK.

3.2.2.3 Tax Benefit

Pursuant to subsection 45B(9), the relevant taxpayer obtains a tax benefit from a demerger if the amount of tax payable or any other amount payable by the relevant taxpayer would, apart from section 45B, be less than the amount that would have been payable or would be payable at a later time than would have been payable, if the demerger benefit or the capital benefit had been an assessable dividend.

We note paragraph 37 of PS LA 2005/21 indicates that in most cases, a relevant taxpayer will obtain a tax benefit within the meaning of 45B(9) of the ITAA 1936 under a demerger.

This is on the basis the dividend and withholding tax exemptions and CGT roll-over relief provided for ensure that the shareholders in the head entity (e.g. PPK shareholders) are not subject to tax on the demerger benefit at the time of the demerger and therefore subject to less tax than if all or part of the in-specie distribution of the PPKMEG shares had been treated as, for example, an assessable dividend.

3.2.3 Having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme did so for a purpose, (whether or not the dominant purpose but not including an incidental purpose), of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c))

In this regard, section 45B is concerned with determining the objective purpose of the persons who entered into or carried out the scheme.

PS LA 2005/21 provides that the approach to determining the objective purpose is that all of the relevant circumstances of the scheme, including the commercial reasons advanced for entry into it, are to be properly considered and weighed against the tax benefits conferred.

Paragraph 1.29 of the Explanatory Memorandum released in relation to the *Taxation Laws Amendment (Company Law Review Bill) 1998* states:

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"The test of purpose under the new section 45B is a test of objective purpose. The question posed by the rule is whether, objectively, it would be concluded that a person who entered into or carried out the scheme, did so for the purpose of obtaining a tax benefit in respect of the capital benefit".

Paragraph 1.31 of the Explanatory Memorandum further states that while section 45B does not require the purpose of obtaining a tax benefit to be the most influential or prevailing purpose, neither does it include any purpose which is not a significant purpose of the scheme. This interpretation has been confirmed by the ATO in PS LA 2005/21 at paragraph 44. As outlined in paragraph 44 of PS LA 2005/21, the purpose must be determined objectively from a consideration of the relevant circumstances of the scheme.

In determining the objective purpose for the provision of a capital benefit and/or a demerger benefit, it is necessary to have regard to the relevant circumstances as listed in subsection 45B(8) and any of the matters listed in subsection 177D(2).

A purpose will be an incidental purpose when it occurs fortuitously or in subordinate conjunction with one of the main or substantial purposes of the scheme, or merely follows that purpose as its natural incident.

Whether a purpose constitutes a more than incidental purpose of the scheme is a matter to be determined objectively from the relevant circumstances of the scheme. PS LA 2005/21 at paragraph 45 states that *"… if the business or commercial purpose for the scheme is not sufficiently cogent, it is likely that the tax purpose will be more than incidental. But if the tax purpose merely follows the commercial purpose as its natural incident, the tax purpose will be incidental."*

The issue of what is an incidental purpose was also considered by the High Court in *Mills v Commissioner of Taxation* (2012) *247 CLR 108* (**"**Mills**"**). The issue considered by the High Court was whether, having regard to relevant circumstances, s177EA should apply to deny imputation benefits to investors and whether the obtaining of the imputation benefits was an incidental purpose. The ATO published its views on Mills in a Decision Impact Statement dated 21 January 2013. In Mills, the High Court concluded whilst there may have been a purpose of enabling a taxpayer to obtain a benefit (i.e. franking credits), this should be considered a subordinate purpose to the dominant purpose of the transaction (i.e. raising finance).

We consider that, having regard to the relevant circumstances of the Demerger, it should not be concluded that any of the persons who entered into or carried out the Demerger did so for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

The relevant circumstances to be considered for the purposes of paragraph 45B(2)(c) are listed in subsection 45B(8). We have addressed the application of these factors below:

(a) the extent to which the demerger benefit or capital benefit is attributable to capital or profits (realised and unrealised) of the company or an associate of the company.

In this context, the word "attributable" is used to describe a discernible connection between the demerger benefit or capital benefit and the share capital and profits of the head entity or an associate. A demerger distribution will generally be considered attributable to the disposal of the demerged entity to the head entity's owners, and thus it would be attributable to the amount of share capital that could reasonably be regarded as having been invested by the head entity's owners in the demerged entity and the profits attributable to the demerged entity.

Paragraph 57 of PS LA 2005/21 sets out the ATO's preferred methodology for attributing the demerger benefit (i.e. distribution of the PPKMEG shares) between capital and profits in the absence of special circumstances. PS LA 2005/21 advises that a "reasonable approach" should be taken to determine the extent to which share capital was invested in the demerged entity (i.e. PPKMEG). The ATO states:

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> *In some cases, the amount of capital contributed by the head entity shareholders that is represented in the investment in the demerged entity can be precisely identified, however in many cases it cannot. In the cases where it cannot be identified, it is apparent from the Explanatory Memorandum to the original section 45B of the ITAA 1936[13] that the exercise envisaged by paragraph 45B(8)(a) [formerly paragraph 45B(5)(a)] involves an economic notion of share capital (the nominal value of which is immutable) being apportioned across the assets of the business. Thus, the amount of share capital invested in the demerged entity should be determined in accordance with the relative market value of the demerged entity to the corporate group.*

We refer to our comments in Section 1 of Appendix A to this letter in respect to the PPK group's activities, market value and capital structure as at 30 June 2018. The PPK Group's activities were limited to its Mining Equipment Business. The PPK group had $15.49m of available share capital at 30 June 2018 and this share capital was invested solely in PPK's Mining Equipment Business. Accordingly, consistent with paragraph 57 of PSLA 2005/21, PPK's share capital attributable to the demerged entity (i.e. PPKMEG) for the purposes of the dividend/capital split should be $15.49m.

The available share capital that can be traced to PPKMEG has been appropriately reduced to $13.49m by the $2.0m loan payable by PPKMEG to PPK at the time of the Demerger.

The above methodology was discussed and agreed with the ATO in the context of the CR Application during April 2021, and as part of that process the ATO ruling team expressed the view that this was the preferred methodology to use having regard to PPK's fact pattern.

For completeness, PPK's capital raisings after 30 June 2018 were applied solely in developing and growing its Technology Business and, therefore, these capital raises have excluded from the dividend/capital split calculation.

Accordingly, the demerger benefit and capital benefit to be provided to the PPK shareholders should reflect an acceptable methodology having regard to PS LA 2005/21 and this should support the conclusion that any of the persons who entered into or carried out the Demerger did not do so for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

(b) the pattern of distributions, bonus shares and returns of capital or share premium by the company or an associate of the company.

In some circumstances, an interruption to the normal pattern of profit distributions and its replacement with a distribution under a demerger may suggest a dividend substitution motive. Accordingly, paragraph 45B(8)(b) requires consideration to be given to the pattern of distributions of dividends, bonus shares and returns of capital by the company and its associates.

PPK has historically paid dividends from time to time when it has been profitable. There is no history of irregular or unusual distributions. PPK resumed paying dividends from the 30 June 2019 year onwards, and has not altered its dividend policy in anticipation of the Demerger.

In our view, the capital reduction and demerger dividend proposed by PPK is the simplest and most efficient way of achieving the Demerger. Therefore, we do not consider the demerger distribution should be viewed as an amount paid in substitution for dividends which would otherwise have been paid by PPK.

For completeness, a breakdown of PPK dividend policy for the years ended 30 June 2010 to 30 June 2021 has been included below.

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Period	Dividends paid out of NPAT $000
30 June 2010	1,450
30 June 2011	1,128
30 June 2012	1,298
30 June 2013	765
30 June 2014	2,100
30 June 2015[1]	2,543
30 June 2016	-
30 June 2017	-
30 June 2018	-
30 June 2019	712
30 June 2020	1,664
30 June 2021	2,219[2]
	856
Total	**14,735**

[1] Dividends paid out of NPAT include a 2014 final ordinary dividend of $1,453,000 and a 2015 interim dividend of $1,090,000.

[2] Consisted of a distribution of Li-S Shares.

(c) to (f) of Subsection 45B(8)

The factors described in paragraphs (c) to (f) of subsection 45B(8) should not contribute for or against a view as to purpose, as the factors are dependent of the circumstances of the particular shareholders.

Although the result to certain participating shareholders may be favourable, as with other demergers undertaken by listed public companies, there is nothing known of the individual circumstances of the PPK shareholders to indicate that the demerger was structured to provide tax benefits to particular shareholders.

We confirm that no PPK shareholders currently hold their PPK shares as pre-CGT assets.

Accordingly, in this case the relevant circumstance outlined in paragraphs 45B(8)(c) to (f) should not provide for or against the relevant conclusion.

(*h) if the scheme involves a distribution of share capital or share premium - whether the interest held by the relevant taxpayer after the distribution is the same as the interest would have been if an equivalent dividend had been paid instead of the distribution of share capital or share premium*

The Demerger will not disturb the existing ownership interests of the PPK shareholders in PPK. All shareholders (i.e. apart from Ineligible foreign shareholders) will participate in the demerger on a pro-rata basis. Accordingly, all shareholders should have a proportionately identical interest by number and value in PPK before and after the demerger.

The number of shares held by PPK shareholders after the demerger will be the same as it would have been if an equivalent dividend had been paid instead of the capital return (i.e. notwithstanding PPK's view that it would not have been practical in any event to pay such a dividend).

(i) if the scheme involves the provision of ownership interests and the later disposal of those interests, or an increase in the value of the ownership interests and the later disposal of those interests:

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i) the period for which the ownership interests are held by the holder of the interests; and
ii) when the arrangement for the disposal of the ownership interest was entered into.

As with all demergers, the arrangement involves the provision of ownership interests in the entity being demerged, in this case PPKMEG. However, the arrangement is not part of a wider arrangement involving the later disposal of the ownership interests in the demerged entity. Any decision as to the subsequent disposal of the PPKMEG shares after demerger will ultimately rest with the holders of those shares post demerger.

As such, we do not believe that paragraph (i) has any relevance, nor can apply, to the proposed demerger.

(j) for a demerger only:

i) whether the profits of the demerging entity are attributable to transactions between the entity and an associate of the entity; and

ii) whether the assets of the demerging entity were acquired under transactions between the entity and an associate of the entity.

The PS LA 2005/21 indicates that paragraph (j) requires regard be had to whether the profits and assets of the demerging entity (in this case PPKMEG) are attributable to or acquired under transactions with associated entities (within the meaning of section 318).

It is an extension of paragraph (a) and looks for the concentration of assets or profits of the corporate group in the demerging entity beyond that which would be explicable by a business restructure, the premise being the demerger is being used to deliver assets or profits tax free to the head entity's owners in the form of an ownership interest.

Given the tax consolidation of the PPK group and the application of the single entity rule, all transactions between PPK and its 100% owned subsidiaries (including PPKMEG) are eliminated and any retained profits are not attributable to transactions between PPK and an associate. Accordingly, the purpose of the Demerger is a transfer of property only from PPK to its shareholders.

(k) any of the matters referred to in subsection 177D(2)

A review of the matters listed in subsection 177D(2) support the view that the Demerger (i.e. or any part of the arrangement) will not be carried out for the purpose of enabling a taxpayer to obtain a tax benefit. In this regard, we set out a discussion in regard to each of the relevant factors in subsection 177D(2) below.

- *The manner in which the scheme was entered into or carried out (paragraph 177D(2)(a))*

This is a reference to the consideration of the method or procedure by which the particular scheme in question was established. In other words, consideration of the decisions, steps, and events that combine to make up the scheme. An inquiry into the manner of a scheme is an objective inquiry into the reasons a taxpayer had for entering into it.

In our view, the manner in which the Demerger is being undertaken is consistent with ordinary commercial demerger transactions undertaken by publicly listed companies, and PPK's commercial reasons for undertaking the demerger are consistent with the policy intent behind the demerger relief measure, that is, to unlock shareholder value by demerging PPK into two independent and specialised businesses, which have their own management, risk and capital requirements.

- *The form and substance of the scheme (paragraph 177D(2)(b))*

The substance of a scheme is a reference to its essential nature which, in the case of a demerger, would normally be determined from the effects of the scheme on the commercial and economic circumstances

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of all the parties involved in the demerger. Thus, this factor looks to whether there is a discrepancy between the form of the scheme and its substance, meaning its commercial and economic substance.

In an ordinary business or commercial dealing, the form of the transaction will be congruent with its substance. As noted above, in our view this is the case with this demerger as the legal form of each step in the demerger and proposed capital reduction is consistent with the commercial and economic substance resulting from those steps.

- *The time at which the scheme was entered into and the length of the period during which the scheme was carried out (paragraph 177D(2)(c))*

This is not limited to a reference to the duration of the scheme, it also includes a reference to the timing of the scheme from the point of view of the scheme's coincidence with events or circumstances beyond the scheme itself. In particular, whether the scheme was designed to take advantage of events or changes of a tax or non-tax nature that were taking place at the time. It is our understanding that there are no events or changes of a tax or non–tax nature that were relevant to PPK's decision regarding the timing of when to separate the businesses in order to enable PPK or its shareholders to obtain a tax benefit.

- *The result in relation to the operation of this Act that but for Part IVA, would be achieved by the scheme (paragraph 177D(2)(d))*

In this instance, regard must be had to the totality of the scheme's relevant tax consequences, to reliably determine the extent to which the scheme did or did not advantage the shareholders from a tax perspective.

We consider that Part IVA should not be applicable to the demerger as the dominant reasons for the Demerger are the commercial reasons as described at Section 3 of Appendix A. Any tax benefits arising from the scheme should be merely incidental.

- *Any change in the financial position of the relevant taxpayer that has resulted, will result or may reasonably be expected to result, from the scheme (paragraph 177D(2)(e))*

This factor directs attention to any change in the financial position of the head entity's owners that results, will result, or may reasonably be expected to result from the scheme.

In financial terms, the Demerger delivers to the PPK shareholders an asset which they can liquidate, exchange, or use as a financial security. The separation of PPK's Mining Equipment Business, from the Technology Business will increase the attractiveness of the Technology Business to, inter alia, investors who have a policy whereby they do not invest in coal related assets. In addition, if the commercial drivers of the Demerger materialise then the financial position of PPK shareholders may improve through higher profitability and a higher share price. This is consistent with the commercial reasons for the demerger.

- *Any change in the financial position of any person who has, or has had, any connection (whether of a business, family, or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme (paragraph 177D(2)(f))*

This section requires that consideration be given to any change in the financial position of any person who has, or has had, any connection with the head entity's owners, being a change that results, will result or may reasonably be expected to result from the Demerger.

The financial position of PPK will change as a result of the demerger, which will be reflected by the demerger of the standalone PPKMEG Group.

We are not aware of any other person connected with PPK or PPK's shareholders whose financial position could reasonably be expected to change due to the demerger. Accordingly, this should not be a

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relevant factor in determining whether the Demerger will be carried out for the purpose of enabling a taxpayer to obtain a tax benefit.

- *Any other consequence for the relevant taxpayer or for any person referred to in (f) above, of the scheme having been entered into or carried out (paragraph 177D(2)(g))*

There are no other consequences (apart from those which have already been discussed) which, in our view, could provide any evidence that a purpose of the demerger is to obtain a tax benefit.

- *The nature of any connection (whether of a business, family, or other nature) between the relevant taxpayer and any person referred to in (f) above (paragraph 177D(2)(h))*

The demerger will be undertaken by an ASX listed company in an arm's length manner and on arm's length terms and conditions involving approval at an Extraordinary General Meeting. Accordingly, this matter should support that the Demerger will be implemented for commercial purposes only and not to obtain a tax benefit.