



Class Ruling

Income tax: demerger of Elementos Limited by Orocobre Limited

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

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

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

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- subsection 109-5(2) of the ITAA 1997;
- section 115-30 of the ITAA 1997; and
- Division 125 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies consists of the shareholders of Orocobre Limited (Orocobre) who:

- (a) were listed on the share register of Orocobre as at the Record Date (30 March 2010);
- (b) were residents of Australia as defined in subsection 6(1) of the ITAA 1936 on the Record Date;
- (c) held their Orocobre 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 Orocobre shares.

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

Qualifications

4. The Commissioner makes this Ruling based on the precise Scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 32 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2009 to 30 June 2011. The Ruling continues to apply after 30 June 2011 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: where certain information has been provided by the applicant on a commercial-in-confidence basis, it will not be disclosed or released under Freedom of Information legislation.

Background

10. On 11 May 2009, Orocobre announced to the Australian Securities Exchange (ASX) that it intended to restructure into two companies:

- Orocobre, which is to remain focused on the development of the Salar de Olaroz Lithium-potash project and the exploration of other Salar minerals; and
- Elementos Limited (Elementos), initially known as Element Minerals, a new copper-gold company which will concentrate on advancing prospective hard rock assets, in particular the Santo Domingo copper-gold molybdenum project.

Relevant entities

Orocobre

11. Immediately prior to the demerger, Orocobre was an Australian resident company listed on the ASX.

12. Orocobre is a lithium-potash resource developer in the Puna region of Argentina. It expects that commercial production will commence in 2011.

13. As at 30 March 2010 Orocobre had 80,817,782 ordinary shares on issue. It also had 775,000 unlisted options on issue.

14. Orocobre distributed 20,000,001 Elementos shares to all Orocobre shareholders in proportion to their share holding in Orocobre as at the Record Date.

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

Elementos

16. Elementos Limited (Elementos) was a subsidiary of Orocobre.

17. Orocobre held 38.89% of the issued capital of Elementos.

18. Elementos through its wholly owned subsidiaries (Element Minerals Australia Pty Ltd and Elementos SA (Argentina)) acquired the non lithium-potash assets of Orocobre.

19. The Elementos group's asset portfolio consisted of cash, cash equivalents and the exploration assets acquired from Orocobre.

The demerger of Elementos

20. The demerger of Elementos from Orocobre was effected by a reduction in the share capital of Orocobre and by payment of a demerger dividend that was satisfied by an *in specie* distribution of 95.24% of the shares in Elementos held by Orocobre to Orocobre shareholders.

21. Orocobre accounted for the distributions that effected the demerger by debiting its share capital account by \$827,000 (the capital reduction amount), and debiting Reserves (retained income/accumulated losses) by \$3,573,000 and making a corresponding credit to the Investments in Elementos Limited account of \$4,400,000 being 95.24% of the fair market value of Elementos.

22. The dividend amount was an amount equal to the difference between the market value of Elementos on the Implementation Date and the capital reduction amount.

Reasons for the demerger

23. Orocobre expected that a number of advantages would accrue to its shareholders as a result of the demerger of Elementos. These advantages include:

- allowing a special purpose management team to focus on the development of gold and base metal projects;
- facilitating the raising of capital from investors focussed on the non lithium-potash assets;
- facilitating the pursuit of growth opportunities and the fast track exploration of the gold and base metal projects; and
- avoiding the dilution of Orocobre shareholders by future capital raisings to fund development of the transferred assets.

Distribution of Elementos shares

24. Orocobre shareholders voted at a general meeting on 23 March 2010 to approve an ordinary resolution to reduce the share capital of Orocobre by an amount which represents the share capital of Orocobre which was applied to the Elementos investment (the capital reduction amount, \$827,000).

25. The capital reduction amount was satisfied by an *in specie* distribution to Orocobre shareholders of 95.24% of its Elementos shares.

26. Orocobre shareholders received one Elementos share for each 4.0408888 Orocobre shares they held on the Record Date.

27. As a result of the demerger, Orocobre shareholders owned shares in both Orocobre and Elementos.

Other matters

28. None of the Orocobre shareholders acquired their shares in Orocobre before 20 September 1985.

29. Orocobre confirmed that capital gains tax (CGT) assets representing more than 50% of the market value of all the CGT assets of Elementos and its subsidiaries would be used directly or indirectly in a business carried on by Elementos or its subsidiaries just after the demerger.

30. Orocobre confirmed that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997 from any of its other accounts and accordingly its share capital account was not tainted (within the meaning of Division 197 of the ITAA 1997).

31. Orocobre has never paid a dividend to its shareholders.

32. Orocobre confirmed it did not make an election under subsection 44(2).

Ruling**CGT consequences*****CGT event G1***

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

34. An Orocobre shareholder made a capital gain when CGT event G1 happened if the market value of the proportion of the capital reduction amount received for each Orocobre share exceeded the cost base of that share. The capital gain is equal to the amount of the excess (subsection 104-135(3) of the ITAA 1997). No capital loss can be made when CGT event G1 happens.

Demerger roll-over relief

35. Orocobre and its subsidiary Elementos were part of a demerger group under subsection 125-65(1) of the ITAA 1997.

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

37. Orocobre shareholders are eligible to choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997.

CGT consequences of choosing roll-over

38. Orocobre shareholders who choose demerger roll-over relief can disregard any capital gain made when CGT event G1 happened to their Orocobre shares under the demerger (subsection 125-80(1) of the ITAA 1997).

Other CGT consequences of choosing roll-over

39. If Orocobre shareholders choose roll-over relief, they must also recalculate the cost base and reduced cost base of their Orocobre and Elementos shares.

40. The first element of the cost base and reduced cost base of each Orocobre share and corresponding Elementos share received under the demerger is worked out as follows:

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

41. The Commissioner accepts that a reasonable apportionment of the total cost base is to:

- attribute 92.7075 % of the total cost base to the Orocobre shares; and
- attribute 7.2925 % of the total cost base to the Elementos shares.

Orocobre shareholders who do not choose demerger roll-over

42. Orocobre shareholders who do not choose demerger roll-over relief:

- are not entitled to disregard any capital gain made when CGT event G1 happened to their Orocobre shares under the demerger; and
- the first element of the cost base and reduced cost base of each Orocobre share and the corresponding Elementos share is calculated in the same manner as if they had chosen demerger roll-over (see paragraphs 40 and 41 of this Ruling (subsections 125-85(1) and (2) of the ITAA 1997)).

Acquisition date of the Elementos shares

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

44. For all other CGT purposes, Orocobre shareholders acquired their Elementos shares on the date that the Elementos shares are transferred to them by Orocobre, being the Demerger Implementation Date (subsection 109-5(2) of the ITAA 1997).

Dividend consequences

45. Any dividend arising under the demerger is a demerger dividend (subsection 6(1)).

46. The demerger dividend is neither assessable income nor exempt income of the Orocobre shareholders (subsections 44(3) and (4)).

47. As the capital reduction amount was debited to Orocobre's share capital account it is not a dividend, as defined in subsection 6(1).

Application of sections 45B, 45BA and 45C

48. The Commissioner will not make a determination under paragraph 45B(3)(a) that section 45BA applies to the whole or any part of any demerger benefit provided to Orocobre shareholders under the demerger.

49. The Commissioner will not make a determination under paragraph 45B(3)(b) that section 45C applies to the whole or any part of the capital benefit provided to participating Orocobre shareholders under the demerger.

Commissioner of Taxation

16 March 2011

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

CGT consequences

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

Conditions for demerger roll-over relief

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

- a shareholder owns a share in a company – this requirement was satisfied as participating shareholders owned shares in Orocobre;
- the company is the head entity of a demerger group – this requirement was satisfied as Orocobre was the head company of a demerger group (see paragraphs 11 to 15 of this Ruling);
- a demerger happens to the demerger group – this requirement was satisfied as a demerger happened to the Orocobre demerger group (see paragraph 20 of this Ruling); and
- under the demerger a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity – this requirement was satisfied because CGT event G1 happened to the Orocobre shares (see paragraphs 33 to 34 of this Ruling) and Orocobre shareholders received Elementos shares under the demerger.

52. Since the Orocobre shareholders to whom this Ruling applies are Australian residents, the condition in subsection 125-55(2) of the ITAA 1997 is not relevant.

53. Under the scheme, the conditions for choosing demerger roll-over relief under Division 125 of the ITAA 1997 were satisfied. Therefore, Orocobre shareholders can choose roll-over relief for the demerger.

Demerger Dividend

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

55. Paragraph (d) of the definition of dividend in subsection 6(1) provides that a dividend excludes amounts debited against an amount standing to the credit of the share capital account of the company.

56. '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.

57. 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.

58. In the circumstances of this demerger, Orocobre debited a capital reduction amount to its 'share capital account' as that term is defined in subsection 6(1) of the ITAA 1936 and section 975-300 of the ITAA 1997. This amount is therefore 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.

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

60. This dividend is neither an assessable income nor an exempt income amount (subsections 44(3) and (4)) if:

- the dividend is a demerger dividend (as defined in subsection 6(1));
- the head entity did not elect that subsections 44(3) and (4) do not apply to the demerger dividend (subsection 44(2)); and
- subsection 44(5) is satisfied.

61. In the present circumstances, each of the conditions in paragraph 60 of this Ruling was satisfied. Therefore, the dividend received by Orocobre shareholders under the demerger is neither assessable income nor exempt income by operation of subsections 44(3) and (4).

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

62. Section 45B applies to ensure that relevant amounts are treated as dividends for taxation purposes if:

- (a) components of a demerger allocation as between capital and profit do not reflect the circumstances of the demerger; or
- (b) certain payments, allocations and distributions are made in substitution for dividends.

63. In this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) are met, the requisite purpose of enabling the Orocobre shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

64. Accordingly, the Commissioner will not make a determination under paragraphs 45B(3)(a) or (b) that either sections 45BA or 45C apply to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; TR 2003/8

Subject references:

- capital benefit
- capital gains
- cost base adjustments
- demerger
- demerger allocation
- demerger benefit
- demerger dividend
- demerger group
- demerger subsidiary
- return of capital on shares

Legislative references:

- ITAA 1936 6(1)
 - ITAA 1936 44
 - 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)
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 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 109-5(2)
 - ITAA 1997 115-30
 - ITAA 1997 115-30(1)
 - ITAA 1997 Div 125
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-55(2)
 - ITAA 1997 125-65(1)
 - ITAA 1997 125-70
 - ITAA 1997 125-80(1)
 - ITAA 1997 125-80(2)
 - ITAA 1997 125-80(3)
 - ITAA 1997 125-85(1)
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 - ITAA 1997 Div 197
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ATO references

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Income Tax ~~ Capital Gains Tax ~~ roll-overs – other

Income Tax ~~ Capital Gains Tax ~~ demerger relief

Income Tax ~~ Return of capital