

CR 2008/39 - Income tax: demerger of Uramet Minerals Limited by Elkedra Diamonds NL



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Class Ruling

Income tax: demerger of Uramet Minerals Limited by Elkedra Diamonds NL

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ⓘ This publication provides you with the following level of protection:

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

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

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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 45BA of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 128B of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 115-30 of the ITAA 1997;
- Division 125 of ITAA 1997;

- Division 855 of ITAA 1997; and
- subsection 995-1(1).

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Elkedra Diamonds NL (Elkedra) who:

- (a) participated in the scheme that is the subject of this Ruling; and
- (b) owned ordinary shares in Elkedra and held those on capital account at the time of the scheme.

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

Qualifications

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 36 of this Ruling.

6. If the scheme actually carried out was 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 2007 to 30 June 2008. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

9. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The following description of the scheme is based on information provided by Norton & Smailes (the applicant for this Ruling).

Note: where certain information has been provided by the applicant on a commercial-in-confidence basis it will not be disclosed or released under the Freedom of Information legislation.

Background

14. The scheme that is the subject of this Ruling involves the demerger by Elkedra of Uramet Minerals Limited (Uramet).

Elkedra

15. Elkedra was, at the time of the scheme, an Australian resident company listed on the Australian Securities Exchange (ASX) and on the Alternative Investment Market (AIM) in the United Kingdom.

16. Elkedra is a diamond mining and production company. Elkedra owns and operates a producing diamond mine in Brazil and carries out exploration for diamonds in Australia. The market value of Elkedra's producing diamond mine in Brazil at the time of the demerger was more than 50% of the sum of the market values of Elkedra's assets.

17. At the time of the demerger, Elkedra had 106,966,910 ordinary shares on issue.

18. Elkedra also had, at the time of the demerger, 12,133,334 unlisted options over ordinary shares. These options represented less than 3% (measured by value) of all ownership interests in Elkedra.

19. There were no other ownership interests in Elkedra just before the demerger.

20. No foreign resident (as that term is defined in subsection 995-1(1) of the ITAA 1997) held, at the time of the demerger, ownership interests in Elkedra that were taxable Australian property (as described in section 855-15 of the ITAA 1997).

Uramet

21. Uramet was, at the time of the demerger, an Australian resident company. It undertakes the business of exploration for uranium and base metals.

22. Just before the demerger, Uramet had a total of 65,000,000 ordinary shares on issue. Elkedra owned 25,000,000 of those ordinary shares, representing 38.46% of the total shares on issue in Uramet at the time of the demerger.

23. There were no other ownership interests in Uramet just before the demerger.

Pre-demerger transactions

24. Before the demerger, Elkedra had transferred its uranium and base metals prospects to Uramet. Elkedra at this time owned 25,000,000 ordinary shares in Uramet at a cost of \$250.

25. Uramet raised \$500,000 of funds by issuing 5,000,000 ordinary shares to 'sophisticated investors'. The funds raised were used to cover the costs of listing Uramet on the ASX and other costs associated with the transfer of the uranium and base metals prospects from Elkedra to Uramet.

26. Uramet then undertook an Initial Public Offer (IPO) on 2 May 2007 to raise monies to fund the uranium and base metals exploration business. Under the IPO, Uramet issued 35,000,000 shares at 20 cents per share, raising a total of \$7,000,000.

27. Uramet listed on the ASX, first trading on 19 June 2007.

The demerger

28. At a General Meeting on 17 August 2007, Elkedra shareholders passed a resolution approving a capital reduction by way of the *in specie* distribution of the 25,000,000 Uramet ordinary shares held by Elkedra.

29. The Elkedra shareholders received approximately one Uramet ordinary share for every 4.2 Elkedra shares they owned just before the demerger.

Accounting for the demerger

30. Elkedra accounted for the demerger by debiting its share capital and profit and loss account by \$250 (the capital reduction amount) and \$4,749,750 respectively, and crediting the shares in Uramet account by \$4,750,000. The capital reduction amount reflects the share capital of Elkedra that was applied to the Uramet investment.

Reasons for the demerger

31. The directors of Elkedra formed the view that the diamond business, and the uranium and base metals exploration business would be more efficiently managed if the two businesses were conducted as separate and distinct entities.

32. This was done to allow Elkedra and Uramet to operate independently with separate Boards and management who will focus on the separate and specific commercial objectives of each business. It also allows Elkedra and Uramet to separately attract funding for the on-going development of the respective businesses.

Other matters

33. None of the Elkedra shareholders acquired their shares in Elkedra before 20 September 1985.

34. Elkedra confirms that no amounts have been transferred to Elkedra's share capital account (as defined in section 975-300 of ITAA 1997) and accordingly its share capital account is not tainted (within the meaning in Division 197 of the ITAA 1997).

35. Just after the demerger, at least 50% of the market value of capital gains tax (CGT) assets owned by Uramet were used in the carrying on of a business.

36. Elkedra did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 not apply to the demerger dividend.

Ruling

(A) CGT consequences for Australian residents

CGT event G1

37. CGT event G1 happened in relation to each of the Elkedra ordinary shares owned by Elkedra shareholders at the time Elkedra made the payment of the capital reduction amount (section 104-135 of the ITAA 1997).

38. Elkedra shareholders made a capital gain under CGT event G1 if the capital reduction amount per Elkedra share exceeded the cost base of the Elkedra share (subsection 104-135(3) of the ITAA 1997).

Disregarding the capital gain under CGT event G1 by choosing demerger roll-over relief

39. A demerger, as described under section 125-70 of the ITAA 1997, happened under the scheme. Therefore, Elkedra shareholders, who were residents of Australia (as that term is defined in subsection 6(1) of the ITAA 1936) at the time of the demerger can choose demerger roll-over relief under subsection 125-55(1) of the ITAA 1997 for their Elkedra shares.

40. Elkedra shareholders will disregard any capital gain made under CGT event G1 if they choose demerger roll-over relief (subsection 125-55(1) and subsection 125-80(1) of the ITAA 1997).

Other consequences of choosing demerger roll-over relief

41. If an Elkedra shareholder chooses demerger roll-over relief, they must also recalculate the cost base and reduced cost base of their Elkedra and Uramet shares.

42. The first element of the cost base (and reduced cost base) of the Elkedra shares and corresponding Uramet shares received under the demerger is worked out by taking the sum of the cost bases of the Elkedra shareholder's shares (just before the demerger) and then apportioning that sum over their remaining Elkedra shares and corresponding new Uramet shares received under the demerger. The apportionment of this sum is done on a reasonable basis having regard to the market values (just after the demerger) of the Elkedra and Uramet shares, or a reasonable approximation of those market values (subsections 125-80(2) and (3) of the ITAA 1997).

Elkedra shareholders who do not choose demerger roll-over relief

43. An Elkedra shareholder who was a resident of Australia at the time of the demerger and who does not choose demerger roll-over relief:

- is not entitled to disregard any capital gain made in respect of CGT event G1 that happened to their Elkedra shares under the demerger; and
- the first element of the cost base and reduced cost base of each Elkedra share and the corresponding Uramet shares is calculated in the manner described in paragraph 42 of this Ruling (subsections 125-85(1) and (2) of the ITAA 1997).

Acquisition date of the Uramet shares for the purposes of the CGT discount

44. For the purpose of accessing the CGT discount, the Uramet shares received by an Elkedra shareholder who was a resident of Australia at the time of the demerger are taken to have been acquired on the same date as the corresponding Elkedra shares (subsection 115-30(1) of the ITAA 1997 (item 2)). This will be the case whether demerger roll-over relief is chosen or not.

(B) CGT consequences for foreign residents

45. An Elkedra shareholder who was a foreign resident (as that term is defined in subsection 995-1(1) of the ITAA 1997) at the time of the demerger, will disregard the capital gain made under CGT event G1 as their shares in Elkedra were not, at that time, 'taxable Australian property' (sections 855-10, 855-25 and 855-30 of the ITAA 1997).

(C) Dividend consequences

Demerger dividend

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

47. The demerger dividend will be neither assessable income nor exempt income of the Elkedra shareholders (subsections 44(3) and (4) of the ITAA 1936). The demerger dividend is not subject to withholding tax under section 128B of the ITAA 1936 (subsection 128B(3D) of the ITAA 1936).

48. As the share capital reduction amount will be debited to Elkedra's share capital account it will not be a dividend, as defined in subsection 6(1) of the ITAA 1936 (see the exclusion contained in paragraph (d) of the definition of a dividend contained in subsection 6(1) of the ITAA 1936).

Application of sections 45B, 45BA and 45C

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

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

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 event G1

51. CGT event G1 happened in relation to the Elkedra ordinary shares owned by Elkedra shareholders at the time that Elkedra made the payment of the capital reduction amount as the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount taken to be a dividend under section 47 of the ITAA 1936 (section 104-135 of the ITAA 1997).

52. An Elkedra shareholder will make a capital gain if the capital reduction amount is more than the cost base of their Elkedra share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

53. An Elkedra shareholder who was a foreign resident at the time of the demerger will disregard any capital gain made under CGT event G1 as their shares in Elkedra were not, at that time, 'taxable Australian property' (sections 855-10, 855-25 and 855-30 of the ITAA 1997).

54. Any capital gain may be disregarded if the Elkedra shareholder chooses demerger roll-over relief. Whether or not demerger rollover relief is chosen, the cost base of the Elkedra shares and the new Uramet shares will be determined by the demerger roll-over provisions.

Demerger roll-over relief

55. Demerger roll-over relief enables a shareholder to choose to disregard a capital gain made as a result of CGT event G1 happening when a non-assessable payment is made in relation to a share under a demerger.

56. The demerger roll-over provisions in Division 125 of the ITAA 1997 contain a number of conditions for eligibility to choose demerger roll-over relief. The main conditions that are relevant to the scheme to which this Ruling relates are:

- (a) a shareholder owns a share in a company;
- (b) the company is the head entity of a demerger group;
- (c) a demerger happens to the demerger group; and
- (d) under the demerger a CGT event happens to the original interest and a new or replacement interest is acquired in the demerged entity.

57. Under the scheme to which this Ruling relates the conditions for demerger roll-over relief under Division 125 of the ITAA 1997 are satisfied. Further, the scheme to which this Ruling relates raises no novel issues of tax law interpretation and no further explanation of the application of those tax laws beyond that contained in the Ruling part of this document is necessary.

Section 45B – schemes to provide certain benefits

58. Section 45B of the ITAA 1936 applies to ensure that relevant amounts are treated as dividends for taxation purposes if:

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

59. In this case, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 are met, the requisite purpose of enabling the Elkedra shareholders to obtain a tax benefit (by way of a demerger benefit or a capital benefit) is not present.

60. Accordingly, the Commissioner will not make a determination under paragraph 45B(3)(a) or (b) of the ITAA 1936 that either sections 45BA or 45C of the ITAA 1936 applies to the scheme to which this Ruling relates.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Subject references:

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

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