


CR 2020/44 - Alkane Resources Ltd - demerger of Australian Strategic Materials Limited

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Class Ruling

Alkane Resources Ltd – demerger of Australian Strategic Materials Limited

📌 Relying on this Ruling

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

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What this Ruling is about

1. This Ruling sets out the income tax consequences for shareholders of Alkane Resources Ltd (Alkane) of Alkane's demerger of Australian Strategic Materials Limited (ASM), which was implemented on 29 July 2020 (Implementation Date).
2. Full details of the demerger are set out in paragraphs 23 to 55 of this Ruling.
3. All legislative references are to provisions of the *Income Tax Assessment Act 1936* or the *Income Tax Assessment Act 1997* (as detailed in the table in the Appendix to this Ruling), unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you held ordinary shares in Alkane and you:
 - were registered on the Alkane share register on 22 July 2020 (Record Date)
 - held your Alkane shares on capital account on the Record Date; that is, you did not hold your Alkane shares as revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1)), and
 - were a resident of Australia, as defined in subsection 6(1), on the Implementation Date.

5. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 23 to 55 of this Ruling.

Note: Division 230 does not apply to individuals, unless they have made an election for it to apply to them.

When this Ruling applies

6. This Ruling applies from 1 July 2020 to 30 June 2021.

Ruling

Demerger relief is available on the separation of ASM from Alkane

7. A demerger, as defined in section 125-70, happened to the Alkane demerger group (which included Alkane and ASM) under the scheme described in paragraphs 23 to 55 of this Ruling. This has income tax consequences as set out in paragraphs 8 to 22 of this Ruling.

Capital gains tax consequences

CGT event G1

8. CGT event G1 happened to your Alkane shares when Alkane paid an amount to you by way of the transfer of ASM shares (section 104-135).

9. You made a capital gain from CGT event G1 happening if the amount of the reduction of share capital for each Alkane share (7.26c) is more than the cost base of your Alkane share. The capital gain is equal to the amount of the difference. No capital loss can be made from CGT event G1 happening (subsection 104-135(3)).

Choosing demerger roll-over

10. You can choose to obtain demerger roll-over under subsection 125-55(1) for your Alkane shares.

11. If you choose demerger roll-over for your Alkane shares, you:

- disregard any capital gain you made when CGT event G1 happened to your Alkane shares under the demerger (subsection 125-80(1))
- must recalculate the first element of the cost base and reduced cost base of your Alkane shares, and calculate the first element of the cost base and reduced cost base of the corresponding ASM shares you acquired under the demerger (subsection 125-80(2)) - see paragraphs 13 to 15 of this Ruling for more details, and
- are taken to have acquired your ASM shares on the Implementation Date (section 109-5), except for the purpose of determining whether you are entitled to make a discount capital gain when a subsequent CGT event happens to your ASM shares you received under the demerger - see paragraph 16 of this Ruling.

Not choosing demerger roll-over

12. If you do not choose demerger roll-over for your Alkane shares, you:
- cannot disregard any capital gain you made when CGT event G1 happened to your Alkane shares under the demerger, and
 - must recalculate the first element of the cost base and reduced cost base of your Alkane shares, and calculate the first element of the cost base and reduced cost base of the corresponding ASM shares you acquired under the demerger (subsections 125-85(1) and 125-85(2)) - see paragraphs 13 to 15 of this Ruling.

Cost base and reduced cost base of your Alkane and ASM shares

13. The first element of the cost base and reduced cost base of each Alkane share and corresponding ASM share is worked out by:
- taking the total of the cost bases of your Alkane shares just before the demerger, and
 - apportioning that total between your Alkane shares and your ASM shares acquired under the demerger.
14. The apportionment is done on a reasonable basis having regard to the market values (just after the demerger) of the Alkane shares and ASM shares, or an anticipated reasonable approximation of those market values (subsections 125-80(2) and 125-80(3)) - see paragraph 55 of this Ruling about the market values of these shares.
15. The Commissioner accepts that a reasonable apportionment is to attribute:
- 83.97% of the total of the cost bases of your Alkane shares just before the demerger to the Alkane shares, and
 - 16.03% of the total of the cost bases of your Alkane shares just before the demerger to the corresponding ASM shares.

Acquisition date of the ASM shares for discount capital gain purposes

16. For the purpose of determining whether you are entitled to make a discount capital gain from a future CGT event that happens to an ASM share you acquired under the demerger, you are taken to have acquired the ASM share on the date you acquired, for CGT purposes, the corresponding Alkane share (table item 2 of subsection 115-30(1)). This is the case whether or not you choose demerger roll-over.

If you held pre-CGT shares in Alkane

17. If you acquired your Alkane shares before 20 September 1985 (pre-CGT Alkane shares), you are entitled to disregard any capital gain you made when CGT event G1 happened to your Alkane shares (subsection 104-135(5)).
18. If you choose demerger roll-over for your pre-CGT Alkane shares, you are taken to have acquired the corresponding ASM shares you obtained under the demerger before 20 September 1985 (subsections 125-55(1), 125-80(4), 125-80(5) and 125-80(6)).

19. If you do not choose demerger roll-over for your pre-CGT Alkane shares:
- none of the corresponding ASM shares acquired under the demerger are taken to be pre-CGT shares
 - you are taken to have acquired those ASM shares on the Implementation Date (section 109-5), and
 - the first element of the cost base and reduced cost base of those ASM shares is calculated in accordance with the rules in Division 110.

Not an assessable dividend

20. You do not include any part of the value of an ASM share which you received under the demerger in your assessable income under subsection 44(1). Although the part of the value of an ASM share that was not debited to the share capital account of Alkane is a 'dividend' under subsection 6(1), it is a 'demerger dividend' under subsections 44(3), 44(4) and 44(5). A demerger dividend is non-assessable non-exempt income.

The anti-avoidance provisions in sections 45B, 45BA and 45C will not apply

21. The Commissioner will not make a determination under paragraph 45B(3)(a) that section 45BA applies to the whole, or any part, of the demerger benefit provided to you under the demerger. This is because the purpose test in paragraph 45B(2)(c) is not satisfied. Therefore, you are not required to include any part of the amount of the demerger benefit (the market value of the ASM shares you obtained under the demerger) in your assessable income under subsection 44(1).

22. 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 you under the demerger. This is because the purpose test in paragraph 45B(2)(c) is not satisfied. Therefore, you are not required to include any part of the amount of the capital benefit (the market value of the ASM shares you obtained under the demerger to the extent that it is not a demerger dividend) in your assessable income under subsection 44(1).

Scheme

23. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

Alkane

24. Alkane is an Australian resident company which was incorporated on 13 May 1969. Alkane shares were listed on the Australian Securities Exchange (ASX) on 7 October 1980.
25. Prior to the Implementation Date, ASM was a wholly-owned subsidiary of Alkane.
26. Alkane is a gold production company with two broad business streams:
- the Tomingley gold mine in the Central West region of New South Wales, together with a multi-commodity exploration and development portfolio which is also predominantly located in that region, and

- the 'construction-ready' Dubbo Project in New South Wales which, once developed, is intended to be a producer of critical materials for advanced technologies such as zirconium, rare earths, hafnium and niobium.
27. Immediately before the demerger, Alkane had on issue:
- 580,033,307 fully paid ordinary shares, and
 - 22,329,762 performance rights held by employees (including directors) issued under the Alkane Resources Performance Rights Plan (ESS interests). The performance rights do not represent more than 3% of the total value of ownership interests (as defined in subsection 125-60(1)) in Alkane.
28. There are no other ownership interests (as defined in subsection 125-60(1)) in Alkane.
29. Prior to the Implementation Date, Alkane had:
- \$269,766,319 credited to its share capital account
 - accumulated profits of \$5,097,569, and
 - equity reserves of \$959,872.
30. Alkane shareholders include Australian residents and a small percentage of shares are held by foreign residents. Its largest shareholder (Abbotsleigh Pty Ltd), together with its related entities, holds approximately 24.762% of the issued share capital in Alkane.
31. In the past 10 years, Alkane has not paid dividends to its shareholders, nor has it returned capital, share premiums or undertaken any capital management transactions.

ASM

32. ASM is an Australian-resident company that was incorporated on 18 March 2014. ASM was previously known as Australian Zirconia Holdings Pty Ltd.
33. ASM has only one class of share on issue, being fully-paid ordinary shares. Immediately before the demerger, Alkane held 100% of the ordinary shares in ASM.
34. ASM and its wholly-owned subsidiaries own assets related to the Dubbo Project. ASM conducts the critical material oxides and metals business (including the Dubbo Project).

The demerger of ASM

35. Alkane stated in its 2019 Annual Report that the board of directors was contemplating a demerger of the Dubbo Project. On 20 May 2020, Alkane formally announced to the ASX the proposed demerger of ASM and the listing of ASM on the ASX.
36. At the extraordinary general meeting held online on 16 July 2020, Alkane shareholders approved the resolution for Alkane to undertake a reduction of share capital of Alkane under sections 256B and 256C of the *Corporations Act 2001* in order to effect the demerger. The date for determining the entitlement of Alkane shareholders to receive ASM shares was 22 July 2020 (Record Date).
37. On 29 July 2020 (Implementation Date), Alkane satisfied the capital reduction by transferring all the ordinary shares in ASM to Alkane shareholders in proportion to their shareholdings in Alkane.

38. On the Implementation Date, Alkane shareholders received one ordinary share in ASM for every five ordinary shares they held in Alkane at the Record Date for the demerger (rounded down to the nearest whole number), and nothing else. Alkane shareholders were not entitled to fractional entitlements to ASM shares, and no fractional entitlements were distributed. Alkane donated the net proceeds of the sale of any ASM shares which were not so distributed to a charity.

39. After the demerger:

- Alkane no longer held any ASM shares, which were all distributed to Alkane shareholders under the demerger (subject to the sale facility discussed at paragraph 49 of this Ruling and the circumstances described at paragraph 38 of this Ruling).
- Alkane shareholders owned shares in both Alkane and ASM.

40. ASM was admitted to the ASX on 29 July 2020. Normal trading of ASM shares commenced on the ASX on 30 July 2020.

Accounting treatment

41. Alkane accounted for the demerger by debiting its:

- share capital account by \$43,237,481 (the capital reduction amount), and
- demerger reserve account by \$92,434,106 (the demerger dividend).

42. The demerger dividend was calculated as the difference between the market value of the ASM shares and the capital reduction amount.

43. The capital reduction amount was worked out as the slice of Alkane's share capital account on the Implementation Date represented by the market value of ASM as a proportion of the combined market value of Alkane and ASM.

44. The market values of ASM and Alkane were calculated by reference to the volume-weighted average prices of Alkane and ASM shares as traded on the ASX over the first five trading days from (and including) 30 July 2020.

Reasons for the demerger

45. The directors of Alkane had for some time been of the view that in the long term, Alkane's two core business streams should be split into separate companies with their own targeted strategy. The directors considered that it was the appropriate time to pursue this course of action.

46. The directors of Alkane formed the view that the demerger would:

- create a Dubbo Project-centric entity with its own board and management team and allow investors keen to gain exposure to critical materials projects (for example, rare earths) to invest in a focused entity
- provide separate funding channels for the Dubbo Project, thereby allowing Alkane to conserve its cash resources for its retained mining interests
- enhance overall shareholder value by allowing a proper recognition of the value of the Dubbo Project assets portfolio held within the group
- allow Alkane to pursue merger and acquisition (M&A) initiatives using its shares and value as a gold company should it choose to do so

- allow Alkane to raise money from investors seeking exposure to Australian gold companies should it choose to do so
- provide a 'share spread' to assist in the ASX listing of ASM, which is an essential element in enabling ASM to attract further capital, and
- ensure shareholders are provided with the flexibility to choose to remain invested in one or both of the businesses.

47. There were no M&A activities or similar proposals contemplated or anticipated by Alkane, prior to the demerger. Alkane had not received any proposals from other entities to acquire Alkane or any of its assets (including ASM).

48. Following the demerger, Alkane will continue to focus its activities on gold mining as well as exploring and evaluating its other mining interests.

Sale facility to some foreign shareholders

49. Under a sale facility for ineligible overseas shareholders, the ASM shares they would have otherwise received were transferred to a sale agent. The sale agent sold those ASM shares on market and the net sale proceeds were remitted to those ineligible overseas shareholders in accordance with their respective entitlements.

Other matters

50. Alkane, being a listed entity, made a choice pursuant to subsection 125-65(5) that Abbotsleigh Pty Ltd is not a member of the demerger group.

51. Immediately before the Implementation Date, Alkane's share capital account was not tainted (within the meaning of Division 197).

52. As Alkane did not make an election under subsection 44(2), subsections 44(3) and (4) apply to the demerger dividend for all Alkane shareholders.

53. Just after the demerger, CGT assets owned by ASM and its demerger subsidiaries (representing at least 50% by market value of all the CGT assets owned by those entities) were used in carrying on a business by those entities (subsection 44(5)).

54. Alkane performance rights were issued in accordance with Division 83A and are interests to which Subdivision 83A-C applies.

55. For the purposes of the cost base and reduced cost base apportionment under subsections 125-80(2) and (3), a reasonable approximation of the market values of an Alkane share and an ASM share just after the demerger was calculated as follows:

- \$1.19413 for each Alkane share, being the volume-weighted average price of Alkane shares as traded on the ASX over the first five trading days from (and including) 30 July 2020.
- \$1.13962 for each ASM share, being the volume weighted average price for ASM shares as traded on the ASX over the first five trading days from (and including) 30 July 2020.

Appendix – Legislative provisions

56. This table sets out the details of the provisions ruled upon or referenced in this Ruling.

<i>Income Tax Assessment Act 1936</i>	subsection 6(1)
<i>Income Tax Assessment Act 1936</i>	subsection 44(1)
<i>Income Tax Assessment Act 1936</i>	subsection 44(2)
<i>Income Tax Assessment Act 1936</i>	subsection 44(3)
<i>Income Tax Assessment Act 1936</i>	subsection 44(4)
<i>Income Tax Assessment Act 1936</i>	subsection 44(5)
<i>Income Tax Assessment Act 1936</i>	section 45B
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(2)(c)
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(3)(a)
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(3)(b)
<i>Income Tax Assessment Act 1936</i>	section 45BA
<i>Income Tax Assessment Act 1936</i>	section 45C
<i>Income Tax Assessment Act 1997</i>	Subdivision 83A-C
<i>Income Tax Assessment Act 1997</i>	section 104-135
<i>Income Tax Assessment Act 1997</i>	subsection 104-135(3)
<i>Income Tax Assessment Act 1997</i>	subsection 104-135(5)
<i>Income Tax Assessment Act 1997</i>	section 109-5
<i>Income Tax Assessment Act 1997</i>	Division 110
<i>Income Tax Assessment Act 1997</i>	subsection 115-30(1)
<i>Income Tax Assessment Act 1997</i>	subsection 125-55(1)
<i>Income Tax Assessment Act 1997</i>	subsection 125-60(1)
<i>Income Tax Assessment Act 1997</i>	subsection 125-65(1)
<i>Income Tax Assessment Act 1997</i>	section 125-70
<i>Income Tax Assessment Act 1997</i>	subsection 125-80(1)
<i>Income Tax Assessment Act 1997</i>	subsection 125-80(2)
<i>Income Tax Assessment Act 1997</i>	subsection 125-80(3)
<i>Income Tax Assessment Act 1997</i>	subsection 125-80(4)
<i>Income Tax Assessment Act 1997</i>	subsection 125-80(5)
<i>Income Tax Assessment Act 1997</i>	subsection 125-80(6)
<i>Income Tax Assessment Act 1997</i>	subsection 125-85(1)
<i>Income Tax Assessment Act 1997</i>	subsection 125-85(2)
<i>Income Tax Assessment Act 1997</i>	Division 197
<i>Income Tax Assessment Act 1997</i>	Division 230
<i>Income Tax Assessment Act 1997</i>	section 977-50
<i>Income Tax Assessment Act 1997</i>	subsection 995-1(1)
<i>Corporations Act 2001</i>	section 256B
<i>Corporations Act 2001</i>	section 256C

References

Previous draft:

Not previously issued as a draft

ATO references

NO: 1-L0R11I6

ISSN: 2205-5517

BSL: PGI

ATOlaw topic: Income tax ~~ Capital gains tax ~~ Rollovers ~~ Demergers – Division 125-C

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