

CR 2021/98 - Archer Materials Limited - return of capital by way of in specie distribution



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Class Ruling

Archer Materials Limited – return of capital by way of in specie distribution

❶ 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.

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What this Ruling is about

1. This Ruling sets out the income tax consequences for Archer Materials Limited (Archer) shareholders who received a return of capital from Archer on 15 October 2021 (Implementation Date) by way of an in specie distribution of shares in iTech Minerals Ltd (iTech).
2. Full details of the in specie distribution are set out in paragraphs 21 to 43 of this Ruling.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you:
 - held Archer shares on 13 October 2021 (Record Date) for the in specie distribution
 - held your Archer shares on capital account; that is, your Archer shares were neither held as revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1))

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- did not acquire your Archer shares pursuant to an employee share scheme, and
- are either
 - a resident of Australia (as that term is defined in subsection 6(1) of the *Income Tax Assessment Act 1936*) (ITAA 1936), or
 - a foreign resident (as that term is defined in subsection 995-1(1)) whose shares in Archer and iTech (acquired as a consequence of the scheme) are not taxable Australian property (as defined in section 855-15) and who are not carrying on a business in Australia at or through a permanent establishment in Australia.

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 21 to 43 of this Ruling. Division 230 will not apply to individuals, unless they have made an election for it to apply.

When this Ruling applies

6. This Ruling applies from 1 July 2021 to 30 June 2022. This Ruling will continue to apply after 30 June 2022 to all entities within the specified class who entered into the scheme during the term of the Ruling.

Ruling

Demerger relief not available

7. Demerger relief (being demerger roll-over under Division 125 and demerger dividend treatment under subsections 44(3) and (4) of the ITAA 1936) is not available as the scheme does not satisfy the requirements of a demerger under subsection 125-70(1).

Return of capital not a dividend

8. No part of the return of capital you received from Archer on the Implementation Date by way of the in specie distribution of shares in iTech is a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

Return of capital is not assessable as ordinary income

9. The return of capital you received from Archer on the Implementation Date by way of the in specie distribution of shares in iTech is not assessable as ordinary income under section 6-5.

Sections 45A, 45B and 45C of the ITAA 1936 do not apply

10. The Commissioner will not make a determination under either subsection 45A(2) or 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to any part of the return of capital by way of in specie distribution you received from Archer on the Implementation Date.

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Capital gains tax consequences**CGT event G1**

11. CGT event G1 happened when Archer made the in specie distribution to you in respect of the Archer shares that you owned at the Record Date and continued to own on the Implementation Date (section 104-135).

12. You made a capital gain if the amount of the return of capital of 20 cents per iTech share you received (multiplied by the number of iTech shares you received) under the in specie distribution is more than the cost base of your Archer shares. The amount of the capital gain is equal to the difference, and the cost base and reduced cost base of your Archer shares is reduced to nil (subsection 104-135(3)). You cannot make a capital loss from CGT event G1 happening (Note 1 to subsection 104-135(3)).

13. If the amount of the return of capital of 20 cents per iTech share you received (multiplied by the number of iTech shares you received) is not more than the cost base of your Archer share, the cost base and reduced cost base of the Archer share are reduced by the amount of the return of capital (but not below nil) (subsection 104-135(4)).

CGT event C2

14. CGT event C2 (section 104-25) happened, in respect of your right to receive the in specie distribution, when Archer made the in specie distribution to you in respect of the Archer shares that you owned at the Record Date and had ceased to own prior to the Implementation Date. That is, where you sold your Archer shares after the Record Date but before the Implementation Date and you received the iTech shares.

15. You made a capital gain if the amount of the return of capital of 20 cents per iTech share you received (multiplied by the number of iTech shares you received) under the in specie distribution is more than the cost base of your right to receive the distribution. The amount of the capital gain is equal to the difference (subsection 104-25(3)).

16. You made a capital loss if the amount of the return of capital of 20 cents per iTech share you received (multiplied by the number of iTech shares you received) under the in specie distribution is less than the reduced cost base of your right to receive the distribution. The amount of the capital loss is equal to the difference (subsection 104-25(3)).

Discount capital gain

17. You can treat a capital gain made when CGT event G1 or C2 happened in respect of the return of capital as a discount capital gain if you acquired your Archer share at least 12 months before the Implementation Date (subsection 115-25(1)), provided the other conditions in Subdivision 115-A are satisfied.

Time of acquisition, cost base and reduced cost base of shares in iTech Minerals Ltd

18. The first element of the cost base and reduced cost base of each iTech share you received on the Implementation Date was 20 cents per iTech share (section 112-20).

19. You are taken to have acquired the iTech share you received by way of the in specie distribution on the Implementation Date (Event number A1 (case 1) of the table in subsection 109-5(2)).

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Foreign-resident shareholders

20. If you are a foreign resident or the trustee of a foreign trust for capital gains tax (CGT) purposes at the Implementation Date, you cannot disregard any capital gain made from CGT event G1, or capital gain or capital loss made from CGT event C2, in relation to your Archer share pursuant to section 855-10 if:

- your Archer share was an indirect Australian real property interest (table item 2 of section 855-15), having satisfied the non-portfolio test in section 960-195 at the Implementation Date, or throughout a 12-month period that began no earlier than 24 months before the Implementation Date and ended no later than that time, or
- you used your Archer share at any time in carrying on a business through a permanent establishment in Australia (table item 3 of section 855-15), or
- you held your Archer share as an individual and your share was covered by subsection 104-165(3) (table item 5 of section 855-15, about choosing to disregard a gain or loss on ceasing to be an Australian resident).

Scheme

21. 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.

Background***Archer Materials Limited***

22. Archer is an Australian-resident company listed on the Australian Securities Exchange (ASX). Archer was incorporated in 2007 and is the head company of an Australian income tax consolidated group comprising Archer and its wholly-owned subsidiaries (The Archer Group).

23. The Archer Group has businesses in the exploration of mineral tenements and an Advanced Materials business in quantum technology, human health and reliable energy. The mineral tenements are exploratory in nature.

24. The development of Archer's Advanced Materials business from a minerals exploration focus to a diverse materials company has happened over time.

25. Archer entered into a Share Sale Deed on 12 April 2021 to dispose of all of the Archer Group subsidiary companies that hold Archer's mineral tenements to iTech (the Sale). Archer disposed of the following wholly-owned subsidiaries to iTech (the Leaving Subsidiaries):

- Archer Pastoral Company Pty Ltd
- Pirie Resources Pty Ltd, and
- SA Exploration Pty Ltd.

26. Archer received 50 million shares in iTech as consideration for the Sale.

27. The disposal of all of the Leaving Subsidiaries to iTech resulted in Archer holding approximately 60% of the iTech shares on issue.

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28. Immediately before the demerger, Archer had 239,251,374 ordinary shares on issue and 13,118,277 unlisted options that had been issued to directors and employees of Archer.

29. Archer has a franking account balance of nil as at 30 June 2020. Archer has not paid a dividend since incorporation.

30. Archer's ordinary share capital account balance is \$32,636,044 as at 31 December 2020.

31. The Archer Group had unlisted options issued with the following characteristics immediately before the demerger:

- 11,618,277 with an exercise price of 19.29 cents each expiring 31 March 2023
- 1,500,000 with an exercise price of 76.95 cents each expiring 31 March 2024
- all options vested on issue.

32. The unlisted options were dealt with as follows:

- the number of options remained the same, and
- the exercise price of each option was reduced by the same amount as the amount returned in relation to each ordinary security.

iTech Minerals Ltd

33. iTech was incorporated in February 2021 and specialises in the discovery and development of minerals and materials for the industrial, battery and critical minerals markets.

34. iTech operates independently of the Archer Group, with its own Board of Directors, Audit, Risk and Compliance Committees, Management Team and Human Resources function.

35. Prior to the Sale, iTech had 10.8 million shares on issue and had two significant shareholders.

36. Prior to completion of the Sale, and as a condition precedent of the Sale, iTech raised \$7 million of capital by listing on the ASX through an Initial Public Offering (IPO).

37. iTech raised \$700,000 of pre-IPO capital to fund the cost of the IPO, corporate advisor and consultants, legal fees, website, marketing IR and insurances, ASX and Australian Securities and Investment Commission fees, and drilling, exploration and working capital.

38. Upon completion of the Sale and successful IPO, iTech's strategy is:

- development of the Halloysite-Kaolinite projects to achieve a significant re-rating of its market capitalisation compared with potential peers
- progress the Campoona Graphite Project through feasibility into development, and
- identification of compelling drill-ready targets from existing data.

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Return of capital and demerger

39. At Archer's General Meeting on 30 August 2021, Archer shareholders approved a reduction of share capital under section 256B of the *Corporations Act 2001*.

40. On the Implementation Date (15 October 2021), Archer implemented the return of capital by making an in specie distribution of the shares in iTech to Archer's shareholders as follows:

- the share capital of Archer was reduced on the Implementation Date by the capital reduction amount, with such amount being applied equally against each Archer share on issue as at the Record Date, and
- the reduction was effected and satisfied by the in specie distribution by Archer to each Archer shareholder of 1 share in iTech for every 4.785 shares held by the Archer shareholder as at the Record Date (rounded down to the nearest whole number of shares).

41. At the Record Date, Archer had 239,251,374 ordinary shares on issue held by Archer shareholders. As at 1 July 2021, only 1.49% of the ordinary shares in Archer were held by overseas-based shareholders based on the mailing address provided by the shareholders.

Archer Materials Limited's share capital account

42. Archer debited its share capital account by an amount of \$10 million to record the in specie distribution of shares in iTech to its shareholders.

43. Archer has confirmed that its share capital account (as defined in section 975-300) is not tainted (within the meaning of Division 197).

Commissioner of Taxation
15 December 2021

Appendix – Explanation

❶ *This Explanation 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.*

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Demerger relief not available

44. For a demerger to happen (as defined in subsection 125-70(1)), there must be a 'demerger group' consisting of one head entity and at least one demerger subsidiary (subsection 125-65(1)). iTech is not a demerger subsidiary of Archer when the restructuring commences.

45. The acquisition of shares in iTech (step 1), and the subsequent distribution of those iTech shares to Archer shareholders (step 2), is a single restructuring for the purposes of the definition of a 'demerger' in subsection 125-70(1). Therefore, the demerger group to which the restructuring happens is the one that existed before step 1 was implemented, at which time iTech was not a member.

Return of capital not a dividend

46. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends paid to the shareholder out of profits derived by the company from any source if the shareholder is a resident of Australia.

47. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution from the meaning of dividend if the amount of the distribution is debited against an amount standing to the credit of the company's share capital account.

48. The term 'share capital account' is defined in section 975-300 as an account which 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.

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49. Subsection 975-300(3) provides that an account is generally taken not to be a share capital account if it is tainted. Archer has confirmed that its share capital account is not tainted within the meaning of Division 197.

50. The return of capital was recorded as a debit to Archer's untainted share capital account. As such, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies and the return of capital is not a dividend.

Sections 45A, 45B and 45C do not apply

51. Sections 45A and 45B of the ITAA 1936 are anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of such a determination is that all or part of the return of capital received by an Archer shareholder by way of the in specie distribution is treated as an unfranked dividend paid by Archer out of profits.

Section 45A – streaming of dividends and capital benefits

52. Section 45A of the ITAA 1936 applies if the capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the capital benefits than other shareholders, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

53. Although a capital benefit (as defined in paragraph 45A(3)(b) of the ITAA 1936) was provided to Archer shareholders under the in specie distribution, there was no streaming of capital benefits to some shareholders as the in specie distribution was paid to all Archer shareholders in direct proportion to their Archer shareholding. Accordingly, section 45A of the ITAA 1936 does not apply to the in specie distribution.

Section 45B – return of capital in substitution for a dividend

54. Section 45B of the ITAA 1936 applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, section 45B of the ITAA 1936 applies where:

- there is a scheme under which a person is provided with a capital benefit by a company
- under the scheme, a relevant taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit, and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into 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 relevant taxpayer to obtain a tax benefit.

55. The return of capital by way of in specie distribution to Archer shareholders constitutes a scheme for the purposes of section 45B of the ITAA 1936.

56. The return of capital by way of in specie distribution was recorded as a debit to Archer's share capital account. Therefore, Archer shareholders were provided with a capital benefit (paragraph 45B(5)(b) of the ITAA 1936).

57. A taxpayer 'obtains a tax benefit' where the amount of tax payable, would apart from the operation of section 45B of the ITAA 1936, be less than the amount that would be

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payable, or would be payable at a later time, if the distribution had instead been a dividend (subsection 45B(9) of the ITAA 1936).

58. As a return of capital will generally result in a lesser amount of tax being payable than an equivalent dividend, Archer shareholders may obtain a tax benefit.

59. Paragraph 45B(2)(c) of the ITAA 1936 sets out an objective purpose test for the Commissioner to consider having regard to the 'relevant circumstances' of the scheme set out in subsection 45B(8) of the ITAA 1936.

60. Having regard to the relevant circumstances of the scheme set out in subsection 45B(8) of the ITAA 1936, it cannot be concluded that the scheme was entered into or carried out for a more than an incidental purpose of enabling Archer shareholders to obtain a tax benefit.

61. The extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or an associate of the company is particularly relevant to the in specie distribution (subsection 45B(8) of the ITAA 1936).

62. Given the corporate history of Archer, it is considered that the capital benefit is attributable to capital rather than profits. As such, this factor supports the conclusion that no person entered into the scheme for a not-incidental purpose of obtaining a tax benefit (subsection 45B(8) of the ITAA 1936).

63. Archer has never paid a dividend to its shareholders and has never made a profit. There is no pattern of distributions of any kind. Therefore, this factor supports the conclusion that no person entered into the scheme for a not-incidental purpose of obtaining a tax benefit.

Part IVA factors

64. It is considered that the matters referred to in subsection 177D(2) of the ITAA 1936, which are relevant circumstances of the scheme pursuant to paragraph 45B(8)(k) of the ITAA 1936, do not support a conclusion that a person entered into the scheme for a not incidental purpose of obtaining a tax benefit.

65. The commercial objectives of the arrangement to demerge the mineral exploration business are such that it is considered that any tax benefit obtained as part of the return of capital by way of the in specie distribution of iTech shares is incidental to those commercial purposes.

66. Accordingly, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the return of capital.

Capital gains tax consequences

CGT event G1

67. CGT event G1 happens if:

- a company makes a payment to a shareholder in respect of a share they own in the company
- some or all of the payment (the non-assessable part) is not a dividend, or an amount that is taken to be a dividend under section 47 of the ITAA 1936, and

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- the payment is not included in the shareholder's assessable income (section 104-135).

68. CGT event G1 happened to your Archer shares when you received the return of capital by way of in specie distribution from Archer in respect of Archer shares you owned at the Record Date and continued to own at the Implementation Date (section 104-135).

69. You made a capital gain when CGT event G1 happened if the amount of the return of capital of 20 cents per iTech share you received (multiplied by the number of iTech shares you received) under the in specie distribution exceeded the cost base of your Archer shares. If so, the capital gain is equal to the amount of the excess and the cost base and reduced cost base of your Archer shares is reduced to nil (subsection 104-135(3)). You cannot make a capital loss when CGT event G1 happens (Note 1 to subsection 104-135(3)).

CGT event C2

70. If, after the Record Date but before the Implementation Date, you ceased to own an Archer share in respect of which the return of capital was made, the right to receive the return of capital in respect of that Archer share is retained by you and is a separate CGT asset from the Archer share.

71. CGT event C2 happened when the return of capital was made. The right to receive the return of capital, being an intangible asset, ended by the right being discharged or satisfied when the return of capital was made (section 104-25).

72. You will make a capital gain under CGT event C2 if the capital proceeds from the ending of the right are more than the cost base of the right. The capital gain is equal to the amount of the excess. You will make a capital loss if the capital proceeds from the ending of the right are less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

73. In working out your capital gain or capital loss when CGT event C2 happens, the capital proceeds are equal to the amount of the return of capital (being 20 cents per iTech share you received multiplied by the number of iTech shares you received) (subsection 116-20(1)).

74. The cost base of your right to receive the return of capital is worked out under Division 110 (modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by you to the extent that it was applied in working out a capital gain or capital loss made when a CGT event happened to the share; for example, when you disposed of your Archer share after the Record Date and before the Implementation Date. Therefore, if the cost base or reduced cost base of the Archer share previously owned by you has been fully applied in working out a capital gain or capital loss on the Archer share, the right to receive the return of capital will have a nil cost base. As a result, you will, in those circumstances, make a capital gain equal to the capital proceeds, being 20 cents per iTech share you received (multiplied by the number of iTech shares you received).

75. For the purposes of Subdivision 109-A, you are considered to have acquired the right at the time when you acquired your Archer share. Therefore, you can treat a capital gain made when CGT event C2 happened on the ending of the right as a discount capital gain under Subdivision 115-A if you acquired your Archer share at least 12 months before the Implementation Date (subsection 115-25(1)) provided the other conditions in Subdivision 115-A are satisfied.

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Non-resident shareholders

76. You disregard a capital gain or capital loss you made from a CGT event if:
- just before the CGT event happened, you are a foreign resident, or the trustee of a foreign trust for CGT purposes, and
 - the CGT event happens in relation to a CGT asset that is not taxable Australian property (subsection 855-10(1)).
77. Your Archer share will be taxable Australian property on the Implementation Date if the Archer share:
- was an indirect Australian real property interest within table item 2 of section 855-15 (see paragraphs 78 to 81 of this Ruling)
 - had been used at any time by you in carrying on a business through a permanent establishment in Australia within table item 3 of section 855-15, or
 - was covered by subsection 104-165(3) within table item 5 of section 855-15, about individuals choosing to disregard capital gains upon ceasing to be Australian residents.
78. An indirect Australian real property interest is a membership interest held by an entity in another entity if the interest passes the principal asset test (section 855-30) and the non-portfolio interest test in section 960-195 (section 855-25).
79. The principal asset test is passed if the sum of the market values of Archer's assets that were taxable Australian real property exceeds the sum of the market values of its assets that were not taxable Australian real property (subsection 855-30(2)).
80. The non-portfolio interest test is passed if the sum of the direct participation interests held in Archer shares by a foreign resident and its associates was 10% or more of the total interests in Archer shares.
81. Therefore, if you are a foreign-resident iTech shareholder, or the trustee of a non-resident trust for CGT purposes, and you and your associates held at least 10% of the direct participation interests in Archer, and your Archer shares pass the principal asset test, you cannot disregard a capital gain made when CGT event G1 or C2 happened in respect of the return of capital under subsection 855-10(1).

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

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