

CR 2022/87 - Iluka Resources Limited - demerger of Sierra Rutile Holdings Limited

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Status: **legally binding**

Class Ruling

Iluka Resources Limited – demerger of Sierra Rutile Holdings Limited

📌 Relying on this Ruling

This publication 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 of the demerger of Sierra Rutile Holdings Limited (Sierra Rutile) by Iluka Resources Limited (Iluka) which was implemented on 4 August 2022 (Implementation Date).
2. Details of this scheme are set out in paragraphs 29 to 54 of this Ruling.
3. In this Ruling, unless otherwise defined, capitalised terms have the meaning as set out in the Glossary of the Demerger Booklet dated 20 June 2022.
4. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Who this Ruling applies to

5. This Ruling applies to you if you held ordinary shares in Iluka (Iluka Shares) and you:
 - were listed on the share register of Iluka as at 5:00 pm AWST on 28 July 2022 (Record Date), and
 - held your Iluka Shares on capital account; that is, you did not hold your Iluka Shares as revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1)) on the Record Date.
6. 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 29 to 54 of this Ruling.

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

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When this Ruling applies

7. This Ruling applies from 1 July 2022 to 30 June 2023.

Ruling**Demerger**

8. A demerger, as defined in section 125-70, happened to the Iluka demerger group, which included Iluka and Sierra Rutile.

Capital gains tax consequences – Australian-resident Iluka Resources Limited shareholders**CGT event G1**

9. On the Implementation Date, CGT event G1 happened when Iluka paid you the reduction of share capital in Iluka by way of the transfer of Sierra Rutile Shares (section 104-135).

10. You will make a capital gain from CGT event G1 happening if the amount of the reduction of share capital for each Iluka Share (9.66c) was more than the cost base of your Iluka Share. The capital gain is equal to the amount of the excess. No capital loss can be made from CGT event G1 (subsection 104-135(3)).

Demerger roll-over

11. You can choose to obtain demerger roll-over under subsection 125-55(1) for your Iluka Shares.

Consequences of choosing demerger roll-over and you had post-CGT Iluka Resources Limited shares

12. If you choose demerger roll-over for your Iluka Shares:

- any capital gain you made when CGT event G1 happened is disregarded (subsection 125-80(1))
- you must recalculate the first element of the cost base and reduced cost base of your Iluka Shares, and calculate the first element of the cost base and reduced cost base of the corresponding Sierra Rutile Shares you acquired under the demerger (subsection 125-80(2) – see paragraphs 16 to 18 of this Ruling), and
- you acquired your Sierra Rutile Shares on the Implementation Date (section 109-5); however, for the purpose of determining your entitlement to a discount capital gain in relation to a subsequent CGT event that happens to the Sierra Rutile Shares, they will be taken to have been acquired when you had acquired the corresponding Iluka Shares (section 115-25 and table item 2 of subsection 115-30(1)).

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Consequences of choosing demerger roll-over and you had pre-CGT Iluka Resources Limited shares

13. If you choose demerger roll-over and you acquired your Iluka Shares before 20 September 1985, you:

- disregard any capital gain you made under CGT event G1 on your Iluka Shares (subsection 104-135(5)), and
- are also taken to have acquired the corresponding Sierra Rutile Shares you received under the demerger before 20 September 1985 (subsections 125-80(4) to (6)).

Consequences of not choosing demerger roll-over and you had post-CGT Iluka Resources Limited shares

14. If you do not choose demerger roll-over for your Iluka Shares, you:

- cannot disregard any capital gain you made when CGT event G1 happened
- must recalculate the first element of the cost base and reduced cost base of your Iluka Shares, and calculate the first element of the cost base and reduced cost base of the corresponding Sierra Rutile Shares you acquired under the demerger (subsections 125-85(1) and (2) – see paragraphs 16 to 18 of this Ruling), and
- acquired your Sierra Rutile Shares on the Implementation Date (section 109-5); however, for the purpose of determining your entitlement to a discount capital gain in relation to a subsequent CGT event that happens to the Sierra Rutile Shares, they will be taken to have been acquired when you had acquired the corresponding Iluka Shares (section 115-25 and table item 2 of subsection 115-30(1)).

Consequences of not choosing demerger roll-over and you had pre-CGT Iluka Resources Limited shares

15. If you do not choose demerger roll-over and you acquired your Iluka Shares before 20 September 1985:

- you disregard any capital gain you made under CGT event G1 on your Iluka Shares (subsection 104-135(5))
- the first element of the cost bases and reduced cost bases of the corresponding Sierra Rutile Shares you received under the demerger is their market value when you acquired them (subsections 110-25(2), 110-55(2) and 112-20(1)), and
- you are taken to have acquired those Sierra Rutile Shares on the Implementation Date (section 109-5).

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Cost base and reduced cost base of your Iluka Resources Limited and Sierra Rutile Holdings Limited shares

16. The first element of the cost base and reduced cost base of each Iluka Share and corresponding Sierra Rutile Share is worked out by:

- taking the total of the cost bases of your Iluka Shares just before the demerger, and
- apportioning that total between your Iluka Shares and the Sierra Rutile Shares you received under the demerger.

17. The apportionment is done on a reasonable basis having regard to the market values (just after the demerger) of the Iluka Shares and Sierra Rutile Shares, or an anticipated reasonable approximation of those market values (subsections 125-80(2) and (3)).

18. The Commissioner accepts that a reasonable apportionment is to attribute:

- 96.52% of the total of the cost bases of your Iluka Shares just before the demerger to your Iluka Shares, and
- 3.48% of the total of the cost bases of your Iluka Shares just before the demerger to your corresponding Sierra Rutile Shares.

Capital gains tax consequences – foreign-resident Iluka Resources Limited shareholders

CGT event G1

19. CGT event G1 happened on the Implementation Date (see paragraph 9 of this Ruling).

20. You will make a capital gain from CGT event G1 happening if the amount of the reduction of share capital for each Iluka Share (9.66c) was more than the cost base of your Iluka share. The capital gain is equal to the amount of the excess. No capital loss can be made from CGT event G1 (subsection 104-135(3)).

21. However, any capital gain you make from CGT event G1 is disregarded unless the Iluka Share was taxable Australian property (section 855-10).

22. An Iluka Share would have been taxable Australian property if it was:

- used by you (the foreign-resident shareholder) in carrying on a business through a permanent establishment in Australia (table item 3 of section 855-15), or
- a CGT asset covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident (table item 5 of section 855-15)).

23. If an Iluka Share was taxable Australian property, you may be able to choose to obtain demerger roll-over in respect of any capital gain under CGT event G1 if the Sierra Rutile Share you acquired under the demerger was also taxable Australian property just after you acquired it (subsection 125-55(2)).

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Cost base and reduced cost base of your Iluka Resources Limited and Sierra Rutile Holdings Limited shares

24. Whether or not demerger roll-over is available to you, you must work out the first element of the cost base and reduced cost base of each Iluka Share and corresponding Sierra Rutile Share in the same way as described in paragraphs 16 to 18 of this Ruling (subsections 125-80(2) and (3), and 125-85(1) and (2)).

Not a dividend

25. No part of the value of a Sierra Rutile Share transferred to you under the demerger will be included in your assessable income under subsection 44(1) of *the Income Tax Assessment Act 1936* (ITAA 1936). Although the part of the value of a Sierra Rutile Share that is not debited to the share capital account of Iluka is a dividend under subsection 6(1) of the ITAA 1936, it will be a demerger dividend under subsections 44(3) to (5) of the ITAA 1936. A demerger dividend is non-assessable non-exempt income for you.

No dividend withholding tax

26. No part of the value of a Sierra Rutile Share transferred to you under the demerger will be subject to dividend withholding tax (subsection 128B(3D) of the ITAA 1936).

Anti-avoidance provisions will not apply to deem an assessable dividend

27. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital benefits provided to you under the demerger. This is because the circumstances of the demerger do not indicate that there was streaming of capital benefits to some shareholders and dividends to other shareholders.

28. As the purpose test in paragraph 45B(2)(c) of the ITAA 1936 is not satisfied, the Commissioner will not make a determination under either:

- paragraph 45B(3)(a) of the ITAA 1936 that section 45BA of the ITAA 1936 applies to the whole, or any part, of the demerger benefit provided to you under the demerger, or
- 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 you under the demerger.

Scheme

29. 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.

Iluka Resources Limited

30. Iluka is an Australian-resident company listed on the Australian Securities Exchange (ASX).

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31. The Iluka Group operates a mineral sands business and has an emerging position in rare earth elements.
32. Immediately before the demerger, Iluka had on issue:
- 424,236,447 fully-paid ordinary shares, and
 - 3,125,087 performance and share rights issued pursuant to various employee incentive plans (ESS interests), representing less than 3% of the total value of ownership interests (as defined in subsection 125-60(1)) in Iluka.
33. Ownership interests in Iluka were acquired before, on and after 20 September 1985.
34. As at 30 June 2022, Iluka had:
- contributed equity of \$1,176.4 million
 - retained earnings of \$233.2 million, and
 - profit reserve of \$173.3 million.
35. Iluka shareholders include both Australian residents and foreign residents and are a mix of individuals, companies, trusts and superannuation funds.
36. No foreign-resident Iluka shareholders held a non-portfolio interest (within the meaning of section 960-195) in Iluka throughout a 12-month period in the 24 months immediately before and on the Implementation Date.
37. Iluka has paid regular dividends based on its underlying performance.

Sierra Rutile Holdings Limited

38. Sierra Rutile is an Australian-resident company and has only one class of shares on issue, being ordinary shares.
39. Before the demerger, Sierra Rutile operated Iluka's Sierra Leone mining operations, which encompasses operations at Lanti and Gangama, a mineral separation plant, and a dedicated port facility. In addition, the mining operations includes the Sembehun project, one of the largest and highest-quality known rutile deposits in the world.
40. Immediately before the demerger, Iluka held 100% of the ordinary shares in Sierra Rutile.

Demerger of Sierra Rutile Holdings Limited

41. On 13 April 2022, Iluka announced it intended to demerge Sierra Rutile, subject to shareholder and other approvals.
42. On 22 July 2022, Iluka shareholders voted at an Extraordinary General Meeting to approve a resolution to demerge Sierra Rutile from Iluka and a resolution under section 256C of the *Corporations Act 2001* to reduce the share capital of Iluka by the Capital Reduction Amount.
43. On the Implementation Date, each Iluka shareholder's entitlement to the Capital Reduction and Demerger Dividend was applied as consideration for the in specie transfer of all the issued Sierra Rutile Shares. Iluka shareholders were entitled to receive one Sierra Rutile Share for each Iluka Share they held on the Record Date.

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44. After the demerger, Iluka held no shares in Sierra Rutile.
45. Sierra Rutile Shares were listed for quotation on the ASX and they commenced trading on a deferred settlement basis on 27 July 2022.

Accounting for the demerger

46. Iluka accounted for the demerger by debiting its:
- share capital account by \$40,987,370.85 (Capital Reduction Amount), and
 - retained earnings account by \$104,780,272.34 (Demerger Dividend).
47. The Demerger Dividend was the difference between the market value of the Sierra Rutile Shares transferred to Iluka shareholders and the Capital Reduction Amount.

Reasons for the demerger

48. The Iluka Board formed the view that the demerger would:
- allow Iluka to focus its capital and management attention on its core Australian mining assets and development opportunities, particularly at Eneabba, where Iluka is developing a fully integrated rare earths refinery
 - enable Sierra Rutile to implement strategies to maximise the value from its existing operations and to continue to progress the globally significant Sembehun Project, and
 - allow current and future shareholders to have the flexibility to choose their level of investment in Iluka and Sierra Rutile.

Sale facility for Ineligible Overseas Shareholders and Small Shareholders

49. A Sale Facility was used to sell Sierra Rutile Shares that would otherwise have been received by Ineligible Overseas Shareholders or Selling Shareholders (being Small Shareholders who elected to participate in the facility) whereby Sierra Rutile Shares were sold on the ASX by a Sale Agent with the sale proceeds, calculated on an average basis and free of any brokerage or stamp duty, remitted to the shareholders.

Other matters

50. Just before the demerger, no Iluka shareholder beneficially held more than 20% of Iluka Shares.
51. Immediately before the Implementation Date, Iluka's share capital account was not tainted (within the meaning of Division 197).
52. Iluka did not elect under subsection 44(2) of the ITAA 1936 that subsections 44(3) and (4) of the ITAA 1936 would not apply to the Demerger Dividend for all Iluka shareholders.
53. Just after the demerger, CGT assets owned by Sierra Rutile 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) of the ITAA 1936).

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54. All of the ESS interests in Iluka are subject to Division 83A and are interests to which either Subdivision 83A-B or 83A-C applies.

Commissioner of Taxation

28 September 2022

Status: **not legally binding**

References

Legislative references:

- ITAA 1936 6(1)
 - ITAA 1936 44(1)
 - ITAA 1936 44(2)
 - ITAA 1936 44(3)
 - ITAA 1936 44(4)
 - ITAA 1936 44(5)
 - ITAA 1936 45A(2)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)(a)
 - ITAA 1936 45B(3)(b)
 - ITAA 1936 45BA
 - ITAA 1936 45C
 - ITAA 1936 128B(3D)
 - ITAA 1997 Div 83A
 - ITAA 1997 Subdiv 83A-B
 - ITAA 1997 Subdiv 83A-C
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-135(5)
 - ITAA 1997 104-165(3)
 - ITAA 1997 109-5
 - ITAA 1997 110-25(2)
 - ITAA 1997 110-55(2)
 - ITAA 1997 112-20(1)
 - ITAA 1997 115-25
 - ITAA 1997 115-30(1)
 - ITAA 1997 125-55(1)
 - ITAA 1997 125-55(2)
 - ITAA 1997 125-60(1)
 - ITAA 1997 125-70
 - ITAA 1997 125-80(1)
 - ITAA 1997 125-80(2)
 - ITAA 1997 125-80(3)
 - ITAA 1997 125-80(4)
 - ITAA 1997 125-80(5)
 - ITAA 1997 125-80(6)
 - ITAA 1997 125-85(1)
 - ITAA 1997 125-85(2)
 - ITAA 1997 Div 197
 - ITAA 1997 Div 230
 - ITAA 1997 855-10
 - ITAA 1997 855-15
 - ITAA 1997 960-195
 - ITAA 1997 977-50
 - ITAA 1997 995-1(1)
 - Corporations Act 2001 256C
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ATO references

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