



Class Ruling

Income tax: bonus share plan: Australian Foundation Investment Company Limited

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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, 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:

- section 6BA of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 of the ITAA 1936;
- section 45 of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45C of the ITAA 1936; and
- section 130-20 of the *Income Tax Assessment Act 1997* (ITAA 1997).

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

Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares in Australian Foundation Investment Company Limited (AFIC) who:

- are listed on the share register of AFIC as at the Record Date for a dividend;
- hold their AFIC shares on capital account;
- are eligible, and choose, to participate in the bonus share plan (BSP);
- are Australian residents for tax purposes; and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their AFIC 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)

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

Qualifications

4. The Commissioner makes this Ruling 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 21 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 2011. 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. The following documents, or relevant parts of them form part of and are to be read with the description:

- Class Ruling application dated 2 November 2011 from the applicant;
- Draft Bonus Share Plan Booklet; and
- 2011 Annual Report for AFIC.

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

10. AFIC is an Australian resident public company listed on the Australian Securities Exchange (ASX). AFIC satisfies the definition of a 'listed public company' under subsection 995-1(1) of the ITAA 1997.

11. AFIC confirms that it satisfies the definition of a 'listed investment company' (LIC) in section 115-290 of the ITAA 1997 and specialises in investing in Australian equities.

12. AFIC has historically paid dividends to its shareholders, twice a year, since 1973. Since 1995 all dividends paid in respect of ordinary shares have been fully franked. It is AFIC's intention to continue this pattern of paying fully franked dividends to ordinary shareholders.

13. AFIC currently offers its shareholders the choice to receive dividends in cash or to participate in a dividend reinvestment plan (DRP). If shareholders participate in the DRP, they are able to have dividends applied by AFIC to fund the purchase of additional fully paid ordinary shares in AFIC. An amount is credited to the share capital account of AFIC in connection with the issue of shares under the DRP equal to the dividend which the shareholder would have otherwise received in cash.

14. AFIC is considering a revision to its dividend policy. In addition to allowing shareholders to choose between receiving cash dividends or participating in the DRP, AFIC is considering the implementation of a BSP.

15. Under the proposed BSP, AFIC shareholders will be able to nominate the number of shares that will participate in the BSP (subject to a minimum and maximum as determined from time to time by the directors of AFIC). To the extent that AFIC shareholders opt not to participate in the BSP, or do not fully nominate for their shareholdings to participate, a dividend will be received.

16. Where an AFIC shareholder elects to participate in the proposed BSP, they will be issued with ordinary shares in AFIC (the bonus shares). The number of bonus shares received will be calculated by multiplying the number of participating shares held at the dividend Record Date by the relevant dividend and then dividing this amount by the issue price. The calculation will be rounded either up or down to the nearest whole number of shares.

17. AFIC shareholders are not required to provide consideration in order to receive the bonus shares under the BSP, rather they will forfeit their entitlement to receive a dividend. AFIC will not credit its share capital account in connection with the issue of bonus shares under the BSP.

18. It is expected that the proposed BSP is to be offered to AFIC shareholders for the foreseeable future and it is the intention of AFIC to continue to declare and pay fully franked dividends.

19. AFIC will offer participation in the BSP to all shareholders excluding those resident in the United States.

20. As AFIC has been listed on the ASX since 1938 some shareholders who choose to participate in the BSP may have acquired their shares before 20 September 1985.

21. As a LIC, AFIC may distribute amounts which may be sourced from LIC capital gains to shareholders who receive a dividend. Shareholders who participate in the BSP will not obtain a benefit in the form of a tax deduction in relation to LIC capital gains which may have been included in dividends foregone.

Ruling

Section 44 – dividend

22. If an eligible AFIC shareholder chooses to participate in the BSP and is issued with bonus shares under the BSP, and if AFIC does not credit its share capital account in connection with the issue of those bonus shares, the value of those bonus shares will not be taken to be a dividend that is included in the assessable income of the eligible AFIC shareholder under section 44 (subsection 6BA(5) and (6)).

Anti-avoidance provisions

23. Section 45 will not apply in respect of the issue of bonus shares under the BSP as it cannot be concluded that shares will be received by certain shareholders while other shareholders receive minimally franked dividends.

24. The Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the whole, or any part, of the bonus shares issued to eligible AFIC shareholders under the BSP.

Cost base of shares

25. If the bonus shares issued under the BSP are issued for no consideration, and are not a dividend or taken to be a dividend, the first element of the cost base and reduced cost base of an eligible AFIC shareholder's ordinary shares will be determined by apportioning the first element of the cost base of the AFIC shares they owned before being issued with bonus shares under the BSP (the 'original shares') over both the bonus shares and the original shares (where the original shares are acquired on or after 20 September 1985 -subsections 6BA(3) and (6) and section 130-20 of the ITAA 1997).

26. Where the original shares are acquired before 20 September 1985, an eligible AFIC shareholder can disregard any capital gain or capital loss made from the bonus shares issued under the BSP (subsection 130-20(3) of the ITAA 1997).

Acquisition date of shares

27. If the bonus shares issued under the BSP are issued for no consideration, and are not a dividend or taken to be a dividend, the bonus shares are taken to have been acquired by the eligible AFIC shareholders at the time the original shares were acquired (section 130-20 of the ITAA 1997).

Commissioner of Taxation8 February 2012

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.***

Section 44 – dividend

28. Section 44 sets out when an amount received as a dividend is to be included as assessable income of a shareholder in a company, but does not apply to the extent to which another provision of the income tax legislation excludes the amount of the dividend from the shareholder's assessable income.

29. The taxation treatment of bonus shares being issued is dealt with in section 6BA. Specifically, subsection 6BA(1) provides that section 6BA applies if a shareholder holds shares in a company (the 'original shares') and the company issues other shares (the 'bonus shares') in respect of the original shares. The ordinary shares which an eligible AFIC shareholder owned before being issued with shares under the BSP are the original shares. The ordinary shares issued under the BSP are the bonus shares.

30. Subsection 6BA(5) provides that, subject to subsection 6BA(6), if a shareholder has a choice whether to be paid a dividend or to be issued shares and the shareholder chooses to be issued with shares:

- (a) the dividend is taken to be credited to the shareholder; and
- (b) the dividend is taken to have been paid out of profits; and
- (c) subsections (2) and (3) apply in working out the consideration for the acquisition of the shares for the purposes of this Act.

31. The effect of subsection 6BA(5) is that the issue of shares will be treated as the payment of a dividend for tax purposes and will be included in the assessable income of the shareholder under section 44.

32. The exception to this treatment is provided for in subsection 6BA(6) which provides that subsection 6BA(5) does not apply if:

- (a) a shareholder in a listed public company (within the meaning of the *Income Tax Assessment Act 1997*) has a choice whether to be paid a dividend (other than a minimally franked dividend within the meaning of subsection 45(3)) or to be issued shares and the shareholder chooses to be issued with shares; and
- (b) the company does not credit the share capital account in connection with the issue of those shares.

33. AFIC is a 'listed public company' under subsection 995-1(1) of the ITAA 1997. If an eligible AFIC shareholder chooses to participate in the BSP, they will be issued with ordinary shares under the BSP in lieu of receiving a more than minimally franked cash dividend. As AFIC will not credit its share capital account in connection with the issue of those shares, the requirements of subsection 6BA(6) will be satisfied.

34. The effect of subsection 6BA(6) is that the value of those shares will not be taken to be a dividend that is included in the assessable income of the eligible AFIC shareholder under section 44.

35. Further, the Note to subsection 6BA(6) states that: 'If subsection (5) does not apply because of this subsection, subsection (3) will apply.' Subsection 6BA(3) provides the rules for determining the tax treatment of the bonus shares issued in the situation where the bonus shares are issued for no consideration for tax purposes and are not taken to be a dividend.

Anti-avoidance provisions

Section 45

36. Section 45 applies in respect of a company that, whether in the same year of income or in different years of income, streams the provision of shares (other than shares to which subsection 6BA(5) applies) and the payment of minimally franked dividends to its shareholders in such a way that:

- (a) the shares are received by some shareholders but not all shareholders; and
- (b) some or all of the shareholders who do not receive the shares receive or will receive minimally franked dividends.

37. If section 45 applies, the value of the share at the time that the shareholder is provided with the share is taken to be an unfrankable dividend that is paid by the company out of its profits. The effect is that the value of the share will be included in the assessable income of the shareholder under section 44.

38. A minimally franked dividend is defined in subsection 45(3) as a dividend that is not franked, or is franked to less than 10%, in accordance with section 202-5 or section 208-60 of the ITAA 1997. AFIC has a history of paying fully franked dividends on its ordinary shares. If AFIC continues this pattern of paying fully franked dividends to ordinary shareholders, there will not be a payment of minimally franked dividends to any of its shareholders.

39. Accordingly, section 45 will not apply in respect of the issue of bonus shares under the BSP, as it cannot be concluded that shares will be received by certain shareholders while other shareholders will receive minimally franked dividends.

Section 45A

40. Section 45A is an anti-avoidance provision which seeks to deal with potential streaming of capital benefits and the payment of capital benefits to shareholders instead of dividends. If the Commissioner makes a determination pursuant to subsection 45A(2), the amount of the capital benefit or a part of the capital benefit received by the shareholder under the BSP is treated as an unfranked dividend.

41. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

42. However, section 45A does not apply in respect of certain capital benefits provided under particular circumstances. Subsection 45A(5) rules out the application of this provision where the capital benefit provided is shares, and it is reasonable to assume that the disadvantaged shareholder has received or will receive fully franked dividends. As previously discussed, AFIC has a history of paying fully franked dividends on its ordinary shares. If AFIC maintains this pattern, section 45A will have no application in respect of the proposed BSP.

43. As section 45A does not apply to the BSP, the Commissioner will not make a determination under subsection 45A(2) that section 45C will apply to the BSP.

Cost base of shares

44. As the bonus shares are issued for no consideration by AFIC, and as they are not a dividend (under section 44) or taken to be a dividend (under section 45 or section 45C), subsection 6BA(3) will apply. For the purposes of the income tax legislation, where any of the original shares or any of the bonus shares are not articles of trading stock of the eligible AFIC shareholder, the following methodology is to be used in determining:

- (i) the amount or value of the consideration paid in respect of the acquisition of any of those shares for the purposes of Part 3-1 or 3-3 of the *Income Tax Assessment Act 1997*; or
- (ii) the amount of any profit or loss arising on the sale or disposal of any of those shares.

45. The methodology prescribed by subsection 6BA(3) is that any amounts paid or payable by the shareholder in respect of the original shares (whether on purchase of the shares, on application for or allotment of the shares, to meet calls or otherwise) shall be deemed to have been paid or to be payable by the shareholder in respect of the original shares and the bonus shares in such proportions as the Commissioner considers appropriate in the circumstances.

46. This means that subsection 6BA(3) is relevant in determining the first element of the cost base and the reduced cost base of the original shares and the bonus shares.

47. The Commissioner considers that an appropriate apportionment in the circumstances of this scheme is that the first element of the cost base and reduced cost base of each parcel of the original shares should be spread in a pro rata manner over both the parcel of original shares and the bonus shares issued in respect of them. The result of this apportionment will be the first element of the cost base and reduced cost base of each of those AFIC shares.

48. A parcel of original shares refers to original shares acquired at the same time for the same consideration per share.

49. Subsection 130-20(1) of the ITAA 1997 provides that section 130-20 of the ITAA 1997 sets out what happens if a shareholder owns shares in a company (the 'original equities') and the company issues other shares (the 'bonus equities') to the shareholder in relation to the original equities. The ordinary shares which an eligible AFIC shareholder owned before being issued with shares under the BSP are the original equities. The bonus shares issued under the BSP are the bonus equities.

50. Item 1 of the table in subsection 130-20(3) of the ITAA 1997 will apply if the following conditions are satisfied:

- none of the bonus shares are a dividend, or taken to be a dividend under subsection 45(2) or 45C(1); and
- an eligible AFIC shareholder acquired the original shares on or after 20 September 1985.

51. If item 1 of the table in subsection 130-20(3) of the ITAA 1997 applies, the eligible AFIC shareholder must apportion the first element of the cost base and reduced cost base of the original shares in a reasonable way over both the original shares and the bonus shares.

52. The Commissioner considers that a reasonable apportionment under item 1 of the table in subsection 130-20(3) of the ITAA 1997 in the circumstances of this scheme will produce the same outcome as subsection 6BA(3) for the first element of the cost base and reduced cost base of each of the original shares and the bonus shares.

53. Item 3 of the table in subsection 130-20(3) of the ITAA 1997 will apply if the following conditions are satisfied:

- none of the bonus shares are a dividend, or taken to be a dividend under subsection 45(2) or 45C(1); and
- an eligible AFIC shareholder acquired the original shares before 20 September 1985 and the bonus shares are fully paid.

54. If item 3 of the table in subsection 130-20(3) of the ITAA 1997 applies, the eligible AFIC shareholder can disregard any capital gain or capital loss made from the bonus shares.

Acquisition date of shares

55. Item 1 of the table in subsection 130-20(3) of the ITAA 1997 provides an acquisition date for the issue of the bonus shares where the original shares were acquired on or after 20 September 1985 (section 6BA does not).

56. The bonus shares are taken to have been acquired when an eligible AFIC shareholder acquired the original shares. This will ensure for the purposes of determining eligibility to a discount capital gain (Division 115 of the ITAA 1997) that the bonus shares are taken to have been acquired on the same date as the original shares.

57. Where the original shares were acquired before 20 September 1985, item 3 of the table in subsection 130-20(3) of the ITAA 1997 provides that the bonus shares are taken to have been acquired when an eligible AFIC shareholder acquired the original shares.

Appendix 2 – Detailed contents list

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

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References

- Previous draft:*
- ITAA 1936 6BA(6)
- Not previously issued as a draft
- ITAA 1936 44
 - ITAA 1936 45
- Related Rulings/Determinations:*
- ITAA 1936 45(2)
 - ITAA 1936 45(3)
 - ITAA 1936 45A
 - ITAA 1936 45A(5)
- TR 2006/10
- Subject references:*
- Bonus shares
 - CGT cost base
 - Dividend income
- ITAA 1997 Div 115
 - ITAA 1997 130-20
 - ITAA 1997 130-20(1)
 - ITAA 1997 130-20(3)
- Legislative references:*
- ITAA 1936 6BA
 - ITAA 1936 6BA(1)
 - ITAA 1936 6BA(2)
 - ITAA 1936 6BA(3)
 - ITAA 1936 6BA(5)
- ITAA 1997 202-5
 - ITAA 1997 208-60
 - ITAA 1997 995-1(1)
 - TAA 1953
 - Copyright Act 1968
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ATO references

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