



Class Ruling

Income tax: proposed return of capital: Chalice Gold Mines Limited

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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 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997; and
- section 855-10 of the 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 shareholders of Chalice Gold Mines Limited (Chalice) who:

- are registered on the Chalice share register on the Record Date for determining entitlements to receive the proposed return of capital;
- hold their Chalice shares on capital account; 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 Chalice shares.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

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 9 to 26 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 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. 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.

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. Chalice is an Australian resident public company listed on the Australian Securities Exchange as of 24 March 2006.

11. Chalice is mainly focused on gold mine development and exploration in Eritrea, East Africa. Prior to September 2012, Chalice had an interest in a total of eight exploration licences, most of which were covered by the Zara Gold Project (Zara Project).

12. In April 2012 a contract was entered into with China SFECO Group for the sale of Chalice's interest in the Zara Project. The sale was completed on 4 September 2012.

13. Chalice held a 60 per cent interest in the Zara Project, directly and indirectly through wholly-owned subsidiaries. Shares in the wholly-owned subsidiaries were acquired by Chalice in 2009 and 2010.

14. In 2009, 2010 and 2011 Chalice raised approximately \$43 million through various capital raisings. Approximately \$40 million was used to:

- acquire interests in the Zara Project;
- continue the ongoing development and exploration of the Zara Project; and
- provide head office support where costs were directly attributable to the Zara Project.

15. Following completion of the sale of the Company's interest in the Zara Project in Eritrea, Chalice has cash on hand of approximately \$81 million, equivalent to a cash backing of approximately 33 cents per share.

16. The Board has undertaken a review of its capital management options and determined that these funds exceed its current capital requirements, providing justification to return some of this capital to shareholders.

17. Subject to shareholder approval Chalice proposes to make a return of capital of up to \$25 million or 10 cents cash per share to its shareholders in early December 2012.

18. The proposed return of capital will be debited wholly to Chalice's share capital account.

19. It will be in the form of cash only and will not result in the cancellation of any shares in Chalice. It will be provided to all shareholders registered on the Chalice share register on the Record Date in the same proportion as their share holdings.

20. The scheme will be subject to shareholder approval. This is expected to occur at the company's Annual General Meeting in November 2012.

21. Chalice has no history of paying any dividends since it was incorporated.

22. Chalice has a diverse shareholder group. The company is not aware of the capital loss profile of its shareholders or the cost base of the shares held by shareholders. However, the proposed return of capital will equate to approximately \$0.10 per share and the company's shares traded between \$0.19 and \$0.75 during the period 2009 to 2012.

23. The company is of the understanding that none of its shareholders' share holdings were acquired, or taken to have been acquired, before 20 September 1985.

24. Foreign shareholders hold approximately 20 to 25 per cent of the shares on issue. The foreign investors are not related parties.

25. Chalice has confirmed that its share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

26. Chalice has confirmed that, at the time of the payment of the proposed return of capital, a Chalice share will not be an 'indirect Australian real property interest' (as defined in section 855-25 of the ITAA 1997). The majority of the assets of Chalice (and its underlying subsidiaries) just prior to the proposed return of capital will comprise:

- cash of approximately \$81 million;
- foreign mining, quarrying and prospecting rights (market value of approximately \$2 to \$4 million); and
- Australian mining, quarrying and prospecting rights (market value of approximately \$0.5 million).

Ruling

Proposed distribution of capital is not a dividend

27. The proposed return of capital to Chalice shareholders will not be a dividend, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C to the proposed return of capital

28. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the proposed return of capital. Accordingly, no part of the proposed return of capital will be taken to be a dividend for income tax purposes.

Capital Gains Tax (CGT) consequences

29. CGT event G1 will happen when Chalice pays the proposed return of capital to a shareholder in respect of a Chalice share that they own at the Record Date for the proposed return of capital and continue to own at the Payment Date for the proposed return of capital (section 104-135 of the ITAA 1997).

30. CGT event C2 will happen when Chalice pays the proposed return of capital to a shareholder in respect of a Chalice share that they own at the Record Date for the proposed return of capital but do not own at the Payment Date for the proposed return of capital (section 104-25 of the ITAA 1997).

Foreign resident shareholders

31. A foreign resident shareholder in Chalice who is paid the proposed return of capital disregards any capital gain made from CGT event G1 happening if their Chalice shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

32. A foreign resident shareholder in Chalice who is paid the proposed return of capital disregards any capital gain made from CGT event C2 happening if their right to receive the proposed return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

5 December 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.*

Proposed distribution of capital is not a dividend

33. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholders out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

34. The term 'dividend' is defined in subsection 6(1) 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.

35. The term 'share capital account' is defined in section 975-300 of the ITAA 1997 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.

36. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account, except for certain limited purposes, if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the account and the account is not already tainted.

37. The proposed return of capital will be recorded as a debit to Chalice's share capital account. As Chalice has confirmed that the share capital account is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) will apply. Accordingly, the proposed return of capital will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

Anti-avoidance provisions

38. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all, or part, of the proposed return of capital amounts received by the shareholders as an unfranked dividend paid by the company out of profits to the shareholders.

Section 45A – streaming of dividends and capital benefits

39. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the receipt of capital than other shareholders (the Disadvantaged Shareholders), and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

40. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) to include the distribution to the shareholder of share capital. Chalice will provide its shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b) when Chalice pays the proposed return of capital to its shareholders. The capital benefit will be provided to all of its shareholders in the same proportion as their share holdings.

41. Therefore, section 45A will not apply to the proposed return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the proposed return of capital.

Section 45B – schemes to provide capital benefits

42. Section 45B applies where certain capital payments, including a return of capital, are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- under the scheme a taxpayer (the relevant taxpayer), who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Scheme

43. A 'scheme' for the purposes of section 45B is taken to have the same meaning as provided in subsection 177A(1) of Part IVA. That definition is widely drawn and includes any agreement, arrangement, understanding, promise, undertaking, scheme, plan or proposal.

44. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). It states that a person is provided with a capital benefit if:

- an ownership interest in a company is issued to a person;
- there is a distribution to the person of share capital; or
- the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest (which may or may not be the same interest) held by that person.

45. As the proposed return of capital will be debited wholly to Chalice's share capital account, Chalice will provide shareholders with a capital benefit under paragraph 45B(5)(b) in the form of a distribution of share capital.

Tax benefit

46. A relevant taxpayer 'obtains a tax benefit' as defined in subsection 45B(9) if:

- the amount of tax payable; or
- any other amount payable under the ITAA 1936 or the ITAA 1997;

would, apart from the operation of section 45B, be less than the amount that:

- would have been payable; or
- would be payable at a later time than it would have been payable;

if the capital benefit had instead been a dividend.

47. The proposed distribution to Chalice's shareholders is a return of capital payment and therefore constitutes a capital benefit. In the event that the distribution was a dividend rather than a capital benefit, it is likely that the amount of tax payable by Chalice shareholders would be greater than is payable in respect of the proposed return of capital payment (the payment being the capital benefit). Consequently, the receipt of the capital benefits will give rise to a 'tax benefit'.

48. Ordinarily, a return of capital would be subject to the CGT provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the shares, there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). It is only to the extent (if any) that the distribution exceeds the cost base of the shares that a capital gain arises. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or, in the case of a foreign resident, be subject to a dividend withholding tax under section 128B of the ITAA 1936. Therefore, Chalice shareholders will obtain a tax benefit from the proposed return of capital.

Relevant circumstances

49. Paragraph 45B(2)(c) requires the Commissioner to consider the 'relevant circumstances' of the scheme as set out in subsection 45B(8). A consideration of these circumstances determines whether any part of the scheme will be entered into for a purpose, other than an incidental purpose, of enabling the relevant taxpayer (a shareholder of Chalice) to obtain a tax benefit.

50. The test of purpose is an objective one. The question is whether it would be concluded that a person who enters into or carries out the scheme does so for the purpose of obtaining a tax benefit for the relevant taxpayer. This requisite purpose does not have to be the most influential or prevailing purpose but it must be more than just an incidental purpose.

51. The purpose which causes section 45B to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is concerned only with the purpose of Chalice. The Commissioner cannot ascertain the purposes of Chalice's numerous shareholders, all of whom may participate in the proposed return of capital. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company, generally speaking, should not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who voted in favour of the payment.

52. The circumstances covered by paragraphs 45B(8)(i) and 45B(8)(j), pertaining to the provision of ownership interests and demergers, respectively, are not relevant. The relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a) to 45B(8)(f), 45B(8)(h) and 45B(8)(k).

53. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised or unrealised) of the company or an associate (within the meaning of section 318) of the company.

54. In this instance, the proposed return of capital will coincide with the disposal of a significant part of the business structure which can be identified as releasing share capital. In approximate terms, of the \$43 million raised by Chalice through capital raisings, \$40 million was invested in the Zara Project. On the sale of the Zara Project, Chalice will return \$25 million to shareholders.

55. Chalice expects that the share capital to be distributed will be surplus to the company's need for it. Following the sale of the Zara Project, Chalice will have only two exploration properties in Eritrea. The exploration and other costs in relation to these properties over the following 12 months are expected to be \$3.5 million. Chalice expects to have a cash balance of approximately \$81 million (after taxes are paid in Eritrea) following the sale of the Zara Project.

56. Therefore, the proposed return of capital is considered attributable to capital only and not to any realised or unrealised profits of Chalice.

57. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate (within the meaning of section 318) of the company. Chalice has no history of paying any dividends since it was incorporated. However, the absence of the payment of dividends does not suggest that the proposed return of capital will be made in substitution for dividends.

58. Paragraph 45B(8)(c) relates to whether the shareholders have capital losses that, apart from the scheme, would be carried forward to a later year of income. As Chalice has a diverse shareholder group, the company is not aware of the capital loss profile of its shareholders. Therefore, this factor tends neither toward nor against the existence of the requisite degree of purpose.

59. Paragraph 45B(8)(d) refers to whether the shareholders acquired, or are taken to have acquired, their shares in Chalice before 20 September 1985. The company is of the understanding that none of the shareholdings were acquired, or taken to have been acquired, before 20 September 1985.

60. Paragraph 45B(8)(e) deals with whether the shareholders are non-residents. Foreign shareholders hold approximately 20 to 25 per cent of the shares on issue. As the foreign investors are not related parties, it is considered that this factor does not lead to the conclusion that the scheme is being carried out to enable the foreign investors to obtain a tax benefit.

61. Paragraph 45B(8)(f) directs that attention be paid to whether the cost base of the shares held by shareholders is not substantially less than the value of the return of capital. The company is not aware of the cost base of the shares held by shareholders. However, the proposed return of capital will equate to approximately \$0.10 per share and the company's shares traded between \$0.19 and \$0.75 during the period 2009 to 2012. On this basis, the cost base of the shares would be more than the value of the proposed return of capital. However, as the proposed return of capital does not involve the cancellation of any shares in Chalice, this is not considered to point towards a tax preference for capital over profit.

62. Paragraph 45B(8)(h) requires a comparison of the respective interests held by shareholders after the distribution. As the proposed return of capital is to be proportional to all shareholders and will not result in the cancellation of any shares in Chalice, the shareholders' substantive interests remain the same as if a dividend was paid instead. Each shareholder's interest after the distribution remains the same comparative with other shareholders. Therefore, this is indicative of the proposed return of capital being in substitution for a dividend.

63. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to 177D(b)(viii). These are matters by reference to which a scheme is able to be examined from a practical perspective in order to identify and compare its tax and non-tax objectives. The matters include the manner in which the scheme is carried out, the timing of the scheme, its form and substance, and the financial and other implications for the parties involved.

64. In this case, the form and substance of Chalice's proposed return of capital does not lead to a conclusion that the requisite purpose exists that the scheme is being carried out for the purpose of enabling the relevant taxpayer to obtain a tax benefit.

65. Accordingly, it cannot be concluded that Chalice or the shareholders of Chalice will enter into or carry out the scheme for the purpose of enabling the shareholders to obtain a tax benefit. As such, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or any part, of the proposed return of capital.

Section 45C

66. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) in relation to the scheme as described, section 45C will not deem any part of the proposed return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or the ITAA 1997.

Capital gains tax consequences

CGT event G1 – section 104-135

67. CGT event G1 (section 104-135 of the ITAA 1997) will happen when Chalice pays the proposed return of capital to a Chalice shareholder in respect of a share that they own in Chalice at the Record Date for the proposed return of capital and continue to own at the Payment Date for the proposed return of capital.

68. If the proposed return of capital is equal to or less than the cost base of the Chalice share at the time of payment, the cost base and reduced cost base of the share will be reduced (but not below nil) by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

69. A Chalice shareholder will make a capital gain if the proposed return of capital is more than the cost base of the Chalice share (subsection 104-135(3) of the ITAA 1997). The amount of the capital gain is equal to the excess.

70. If a Chalice shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the Chalice share is reduced to nil. A Chalice shareholder cannot make a capital loss when CGT event G1 happens (subsection 104-135(3) of the ITAA 1997).

71. A capital gain made when CGT event G1 happens will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the Chalice share was acquired at least 12 months before the payment of the proposed return of capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Subdivision are satisfied.

CGT event C2 – section 104-25

72. The right to receive the proposed return of capital is one of the rights inherent in a Chalice share at the Record Date for the proposed return of capital. If, after the Record Date but before the Payment Date for the proposed return of capital, a Chalice shareholder ceases to own a Chalice share, the right to receive the proposed return of capital in respect of that share will be retained by the shareholder and is a separate CGT asset.

73. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the proposed return of capital is paid and the right to receive the payment (being an intangible CGT asset) ends.

74. A Chalice shareholder will make a capital gain if the capital proceeds from the ending of the right are more than its cost base. The capital gain is equal to the amount of the excess. A Chalice shareholder will make a capital loss if the capital proceeds from the ending of the right are less than its reduced cost base (subsection 104-25(3) of the ITAA 1997). The capital loss is equal to the amount of the difference.

75. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the proposed return of capital at that time (subsection 116-20(1) of the ITAA 1997).

76. The cost base of a Chalice shareholder's right to receive the proposed return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the Chalice shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share – for example, when the Chalice shareholder disposed of the share after the Record Date for the proposed return of capital.

77. Therefore, if the full cost base or reduced cost base of a Chalice share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share, the right to receive the proposed return of capital will have a nil cost base.

78. As the right to receive the proposed return of capital was inherent in the Chalice share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997). Accordingly, if the Chalice share was acquired at least 12 months before the proposed return of capital, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided the other conditions of that Subdivision are satisfied.

Foreign resident shareholders

79. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss made from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

80. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out five categories of CGT assets:

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

81. Chalice has advised that, at the time CGT event G1 happens for any foreign resident Chalice shareholder who is entitled to the proposed return of capital, a Chalice share will not be an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997) as the interest will not pass the principal asset test in section 855-30 of the ITAA 1997 at that time.

82. However, a foreign resident Chalice shareholder, just before CGT event G1 happens, cannot disregard under subsection 855-10(1) of the ITAA 1997 a capital gain made if:

- (a) the Chalice share has been used at any time by the foreign resident Chalice shareholder in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- (b) the Chalice share is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

83. A Chalice foreign resident shareholder who has a right to the payment of the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens to that right because the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

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- capital reductions
- CGT event C1-C3 – end of a CGT asset
- CGT event G1-G3 – end of a CGT asset
- return of capital on shares
- share capital
- shareholder payments

Legislative references:

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- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
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