



Class Ruling

Income tax: returns of share capital: IPE Limited

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① 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*. (TAA 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.

Summary – 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 provisions

2. The relevant provisions dealt with in this Ruling are:
- subsection 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
 - section 885-10 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 the holders of ordinary shares in IPE Limited (IPE) who:

- were listed on the IPE share register on the relevant date (Record Date) for determining entitlements to receive the returns of share capital made on 25 November 2016 and/or 12 April 2017
- did not hold their IPE shares as revenue assets (as defined in section 977-50 of the ITAA 1997) nor as trading stock (as defined in subsection 995-1(1) of the ITAA 1997), that is they held their IPE shares on capital account, and
- were not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their IPE shares.

(**Note:** Division 230 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 'IPE shareholder'.

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 8 to 24 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.

Date of effect

7. This Ruling applies from 1 July 2016 to 30 June 2017. The Ruling continues to apply after 30 June 2017 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

8. The following description of the scheme is based on the class ruling application and other correspondence 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.

Background

9. IPE is an Australian resident company which has been listed on Australian Securities Exchange (ASX) since November 2004.

10. IPE's primary business activity is investing in private equity funds which usually have an investment period of five or six years from the initial commitment date.

11. IPE's board determined in 2008 that IPE would cease making new investments and would instead be wound down over time.

12. IPE keeps accounts and portfolio records of its investments such that it is able to identify all of its receipts as one of the following:

- a return of capital invested
- a capital gain on capital invested, or
- income generated by capital invested.

Status of the IPE portfolio – capital now excess to requirements

13. In recent years, IPE had been able to pay dividends to its shareholders purely out of profits (being income and capital gains arising from its investments in private equity funds). It had used the capital returns from the private equity funds to satisfy calls from other private equity funds in respect of its commitments.

14. IPE's position changed in 2014 with the completion of the investment phases of the funds in which IPE invests. Capital returns received by IPE were then (and now) surplus to its needs. With the undrawn commitments amount at a low level, IPE started to deliver cash back to its shareholders. Part of that cash is not income generated by capital invested or capital gains on capital invested; it has the character of capital, in the sense that it flows from returns of capital invested in private equity funds, arising from the disposal of assets by those funds.

Returns of share capital

15. IPE paid returns of share capital of 3.80 cents per share on 25 November 2016 amounting to \$5,154,476 and 2.70 cents per share on 12 April 2017 amounting to \$3,662,391 (returns of share capital). These returns of capital were approved by IPE's shareholders and were paid equally to each shareholder listed on IPE's share register on the Record Date for each of these returns of share capital.

16. The Record Date of each return of share capital and the date when each return of share capital was paid by IPE all occurred during year ending 30 June 2017.

17. IPE debited the entire amount of each return of share capital against the company's share capital account. There was no change in either the number of IPE shares on issue or the proportionate interest of each shareholder in IPE. The returns of share capital were sourced from IPE's existing net cash reserves.

Others

18. The IPE half-yearly report for the half-year ended 31 December 2016 disclosed:

- a net loss after tax of \$246,000
- issued capital of \$45,099,000
- accumulated losses of \$24,580,000, and
- total equity of \$20,519,000.

19. IPE has consistently paid dividends during the last 5 years including a fully franked dividend of \$2.98 million and an unfranked dividend of \$1.63 million during the financial year ending 30 June 2017.

20. The returns of share capital made by IPE do not reflect any changes in its dividend policy.

21. Prior to the above returns of share capital paid, IPE has paid returns of share capital during the financial years ending 30 June 2015 and 30 June 2016.

22. IPE has also undertaken an on-market buyback of shares during the 2016 financial year which is still ongoing. As at 31 March 2017, IPE has bought back 927,103 shares under the on-market buyback of shares amounting to \$242,876.

23. As at 31 March 2017, IPE had 1,957 shareholders on its share register. The top 20 shareholders held approximately 59.79% of the shares on issue, and a minority group of non-residents held some of the IPE shares.

24. IPE's share capital account (as defined in section 975-300 of the ITAA 1997) was not tainted within the meaning of the Division 197 of the ITAA 1997.

Ruling

Returns of share capital not dividends

25. The returns of share capital paid to IPE shareholders are not dividends as defined in subsection 6(1).

The application of sections 45A, 45B and 45C

26. The Commissioner will not make a determination under section 45A or section 45B that section 45C applies in relation to the returns of share capital received by IPE shareholders.

Capital gains tax (CGT) consequences

27. CGT event G1 (section 104-135 of the ITAA 1997) happened when IPE paid each return of share capital to an IPE shareholder in respect of an IPE share that they owned at the relevant Record Date and continued to own at the relevant Payment Date.

28. CGT event C2 (section 104-25 of the ITAA 1997) happened when IPE paid each return of share capital to an IPE shareholder in respect of an IPE share that they owned at the relevant Record Date, but ceased to own before the relevant Payment Date.

Foreign resident shareholders

29. An IPE shareholder who was a foreign resident just before CGT event G1 happened disregards any capital gain made when CGT event G1 happened if their IPE shares were not 'taxable Australian property' (section 885-10 of the ITAA 1997).

30. An IPE shareholder who was a foreign resident just before CGT event C2 happened disregards any capital gain or capital loss made when CGT event C2 happened if their right to receive each return of share capital was not 'taxable Australian property' (section 855-10 of the ITAA 1997).

CR 2017/45

Commissioner of Taxation

26 July 2017

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.*

Returns of share capital not dividends

31. 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.

32. 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.

33. Section 975-300(3) of the ITAA 1997 provides that an account is generally taken not to be a share capital account if it is tainted. IPE has confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997.

34. Each return of share capital was recorded as a debit to IPE's share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) applies and neither distribution of share capital is a dividend as defined in subsection 6(1).

The application of sections 45A, 45B and 45C

35. 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 each return of share capital received by IPE shareholders as an unfranked dividend paid by the company out of profits.

Section 45A – streaming of dividends and capital benefits

36. 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 the Disadvantaged Shareholders receive, or are likely to receive, dividends.

37. 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.

38. Although a 'capital benefit' was provided to IPE shareholders, the circumstances of the returns of share capital indicate that there was no streaming of capital benefits to some IPE shareholders and dividends to the other IPE shareholders.

39. Accordingly, 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 returns of share capital.

Section 45B – scheme to provide capital benefits

40. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, subsection 45B(2) applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company.
(paragraph 45B(2)(a))
- (b) 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
- (c) 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 taxpayer (the **relevant taxpayer**) to obtain a tax benefit.
(paragraph 45B(2)(c)).

41. Each return of share capital satisfies the conditions in paragraphs 45B(2)(a) and 45B(2)(b). However, having regard to the relevant circumstances of each scheme (comprising each distribution of share capital paid), it cannot be concluded that the scheme was entered in to or carried out for a more than incidental purpose of enabling IPE shareholders to obtain a tax benefit.

42. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or a part, of the payments of the returns of share capital.

Capital gains tax (CGT) consequences

CGT event G1 – section 104-135 of the ITAA 1997

43. CGT event G1 happened when IPE made each return of share capital to an IPE shareholder in respect of a share that the shareholder owned at the relevant Record Date and continued to own at the relevant Payment Date (section 104-135 of the ITAA 1997).

44. An IPE shareholder made a capital gain if each return of share capital was more than the cost base of the shareholders' IPE share. The amount of the capital gain was equal to the excess. (subsection 104-135(3) of the ITAA 1997).

45. If an IPE shareholder made a capital gain when CGT event G1 happened, the cost base and reduced cost base of the IPE share are reduced to nil. An IPE shareholder cannot have made a capital loss when CGT event G1 happened (Note 1 to subsection 104-135(3) of the ITAA 1997).

46. If each return of share capital, of 3.80 cents per share and 2.70 cents per share respectively, was equal to or less than the cost base of the IPE share at the time of payment, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

47. A capital gain made when CGT event G1 happened is eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided that IPE shareholder acquired the IPE share at least 12 months before the payment of the return of share capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of Division 115 are satisfied.

48. An IPE shareholder who was a foreign resident or temporary resident must meet further conditions to be eligible to treat the capital gain as a discount capital gain under Division 115 of the ITAA 1997.

CGT event C2 – section 104-25 of the ITAA 1997

49. CGT event C2 happened when each return of share capital was paid to an IPE shareholder that held the share at the relevant Record Date but no longer owned the share at the relevant Payment Date (section 104-25 of the ITAA 1997).

50. The right to receive each return of share capital was one of the rights inherent in an IPE share held at the Record Date. If, after the Record Date but before the Payment Date, an IPE shareholder ceased to own an IPE share in respect of which each return of share capital was payable, then the right to receive the return of share capital was retained by that shareholder and constituted a separate CGT asset.

51. The right to receive each return of share capital was ended by the right being discharged or satisfied when the payment was made.

52. An IPE shareholder made a capital gain if the capital proceeds from the ending of the right were more than the cost base of the right. The capital gain is equal to the amount of the excess. An IPE shareholder made a capital loss if the capital proceeds from the ending of the right were less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3) of the ITAA 1997).

53. In working out the capital gain or capital loss made when CGT event C2 happened, the capital proceeds were the amounts of returns of share capital paid (3.80 cents per share and 2.70 cents per share respectively) (subsection 116-20(1) of the ITAA 1997).

54. The cost base of the IPE shareholder's right to receive each return of share 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 an IPE shareholder that was applied in working out a capital gain or capital loss made when a CGT event happened to the share, for example, when the IPE shareholder disposed of the share after the relevant Record Date.

55. Therefore, if the entire cost base or reduced cost base of the IPE share was applied in working out a capital gain or capital loss when a CGT event happened to that share, then the right to receive each return of share capital was likely to have a cost base of nil. Therefore, the IPE shareholder generally made a capital gain equal to the amount of each return of share capital of 3.80 cents per share and 2.70 cents per share respectively.

56. As the right to receive the payment of each return of share capital was inherent in the IPE 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).

57. Accordingly, if the IPE share was acquired at least 12 months before the payment of each return of share capital, a capital gain made from the ending of the corresponding right satisfies the requirements of section 115-25 of the ITAA 1997. The capital gain may be eligible to be treated as discount capital gain under Division 115 of the ITAA 1997 provided the other conditions of Division 115 of the ITAA 1997 are satisfied.

58. An IPE shareholder who was a foreign resident or temporary resident must meet further conditions to be eligible to treat any capital gain as a discount capital gain under Division 115 of the ITAA 1997.

Foreign resident shareholders

59. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss made from a CGT event if:

- just before the CGT event happened, the entity is 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'.

60. 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 Australian resident)

61. An IPE shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event G1 happened to their IPE share under subsection 855-10(1) if:

- (a) their IPE share was an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997), or
- (b) their IPE share had been used at any time by them 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
- (c) their IPE share was covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

62. An IPE shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event C2 happened to their right to receive a return of share capital if:

- (a) the right had been used at any time by them 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 right was covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; CR 2014/50;
CR 2015/42; CR 2016/46

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45C
- ITAA 1997
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
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- ITAA 1997 975-300
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ATO references

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Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events C1 to C3 – end of a CGT asset
Income tax ~~ Capital management ~~ Anti avoidance rules ~~ Section 45A
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