

Ruling Compendium – TR 2010/4

This is a compendium of responses to the issues raised by external parties to draft TR 2009/D5 – Income tax: capital gains: when a dividend will be included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement.

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses¹

Issue No.	Issue raised	ATO Response/Action taken
1.	Paragraph 10 Clarification of each factor identified in paragraph 10 of the draft TR is warranted	
1.1.	The draft Ruling indicates that a dividend would form part of capital proceeds where only one of the following three factors in paragraph 10 is present in a disposal of shares by contract: • if the vendor shareholder is entitled under the contract to refuse to complete the transfer if the dividend is not declared by the target company or if the dividend is not paid by the target company; • if the vendor shareholder is entitled to refuse to complete the transfer if a purchaser or third party does not finance or facilitate payment of the dividend; • if the vendor shareholder has bargained for any other obligation on the part of the purchaser to bring about the result that the dividend shall be received by the vendor shareholder. The final ruling should clarify the minimum circumstances that would give rise to a dividend forming part of the capital proceeds, either by way of separate examples or further commentary at the end of Example 1.	Paragraph 10 of the final Ruling has been amended (and a further paragraph inserted, paragraph 11) to clarify this aspect.

¹ Unless otherwise indicated, references to examples and paragraphs in the Issue raised column are to TR 2009/D5 (the draft Ruling) and in the ATO Response/Action taken column to TR 2010/4 (the final Ruling).

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Page status: **not legally binding**

Page 2 of 8

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1.2.	Example 1 considers a situation where multiple factors detailed in paragraph 10 are present. If the funding of the dividend in Example 1 is not financed/facilitated by the purchaser, would paragraph 10 not be satisfied?	The examples provided in the draft Ruling are not intended to cover all factual scenarios. They merely provide one example of how the basic principles described apply. On this basis, whether any variation of the facts of Example 1 (such as the absence of funding by the purchaser) satisfies the requirements described in paragraph 10 (or 11) of the final Ruling will depend on the circumstances of the entire arrangement, including the specific rights and obligations stemming from the agreement for the disposal of shares between the purchaser and the vendor shareholder. It is highlighted however that the receipt of the dividend by Acheron and Belus in Example 1 is a term of the agreement to sell their shares in Kronuz (as noted in paragraph 13 of the final Ruling). It is therefore considered that, even if the dividend was not financed by the purchaser, it would nevertheless be capital proceeds in respect of CGT event A1 happening as it would meet dot point 1 in paragraph 10.
1.3.	A question arises as to whether the actual dividend ultimately paid would form part of the capital proceeds, if the facts in Example 1 are varied such that the sale price is \$130M minus any dividend payment, but the purchaser and vendor had <u>not</u> promised to each other that a dividend would be declared and funded.	The presence of an 'adjustment clause' in a contract for the sale of shares will not in isolation cause a dividend to be included in capital proceeds. Other factors, such as a dividend being payable in accordance with the contract (as noted in paragraph 73 of the final Ruling) or those described in paragraph 10 or 11 of the final Ruling, must also exist for a dividend to be sufficiently linked to the CGT event.

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Page status: **not legally binding**

Page 3 of 8

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1.4.	On the other hand, where promises were made by the purchaser and/or vendor, but these promises were not ultimately needed (for example, purchaser agreed to provide funding if necessary, but in the end, did not actually fund the payment of the dividend because the target company had sufficient surplus cash), would a dividend still form part of capital proceeds for the disposal of the shares?	Dot point 2 in paragraph 10 of the final Ruling states that a dividend will be capital proceeds of CGT event A1 happening in respect of the disposal of shares under a contract if... 'the vendor shareholder <i>is entitled</i> (emphasis added) to refuse to complete the transfer if a purchaser or third party does not finance or facilitate payment of the dividend. This attribute would be satisfied irrespective of whether the purchaser actually finances or facilitates payment of the dividend.
1.5.	It would be beneficial if the final ruling could explain, either by way of example or further commentary, whether a dividend would form part of the capital proceeds where a term of the contract provides that the purchase price of the shares would be adjusted for any dividend paid but no obligation arises under the contract for either the vendor company to declare the dividend or the purchaser (or third party) to fund the payment of the dividend.	This issue has generally been addressed in issue 1.3 (as well as issues 1.2 and 1.4).
Interaction with paragraphs 53 and 54		
1.6.	The final ruling should address whether dividends paid during the commercial process of making a company 'ready for sale' for example, dividends paid after entering into a 'Heads of Agreement' would be included as capital proceeds and/or clarify whether such payments would be covered by the exception in paragraph 53 of the draft Ruling.	Depending on the specific facts of the arrangement, it is possible that dividends paid during the commercial process of making a company 'ready for sale' may come within the exception described in paragraph 59 of the final Ruling, being coincidental and not in respect of the sale.
1.7.	The draft Ruling would benefit if further specific examples were provided of the situations covered by paragraph 54 that is, where payment of the distribution forms part of the disposal transaction, and the buyer participates in it in some way, so that the distribution is not purely an affair between the company and its shareholders.	This issue is primarily a question of fact and no further explanation in the final Ruling is considered appropriate.

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Page status: **not legally binding**

Page 4 of 8

Issue No.	Issue raised	ATO Response/Action taken
	Clarification of 'any other obligation bargained for'	
1.8.	Further clarification would be beneficial on the scope and application of the third factor listed in paragraph 10 of the draft Ruling that is, if the vendor shareholder has bargained for any other obligation on the part of the purchaser to bring about the result that the dividend shall be received by the vendor shareholder.	This issue is primarily a question of fact and no further explanation in the final Ruling is considered appropriate.
1.9.	If, as suggested by the use of the words 'among others cases', paragraph 10 of the draft Ruling is a non-exhaustive list of examples, the ruling should outline any other circumstances under which the ATO believes that a dividend would form part of the capital proceeds.	Paragraph 10 of the final Ruling has been amended (and a further paragraph inserted, paragraph 11) to clarify this aspect.
2.	Paragraphs 24 and 67 Provision of examples or further clarification of the comments made in paragraphs 24 and 67 of the draft Ruling	
2.1.	It is recommended that an example or further clarification be inserted in the draft Ruling to clarify when a dividend would be considered to be part of capital proceeds as a result of the purchaser of the shares under the contract (or its associate) participating <i>in arrangements in respect of the dividend collateral to the contract for the sale of shares</i> (as stated in paragraph 24 of the draft Ruling).	This issue is primarily a question of fact and no further explanation in the final Ruling is considered appropriate.
2.2.	In respect of paragraph 67 of the draft Ruling and the operation of adjustment clauses, further clarification of when a dividend is or is not payable in accordance with the contract is needed.	Paragraph 73 of the final Ruling (paragraph 67 in the draft Ruling) is considered to be sufficiently clear and as such no changes have been made to this paragraph.

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Page status: **not legally binding**

Page 5 of 8

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3.	Revisiting tax policy outcomes	
3.1.	The draft Ruling will have implications for the availability of scrip for scrip rollover relief under Subdivision 124-M of the <i>Income Tax Assessment Act 1997</i> (ITAA 1997) and the cost base of replacement interests acquired by an original interest holder. In light of these consequences, it is recommended that Treasury be consulted to ensure that the draft Ruling achieves the right policy outcome.	The ATO considers that this matter is beyond the scope of this Ruling and accordingly has not expanded the final Ruling to cover same. No consultation with Treasury is proposed at this stage. Policy aspects may be more broadly discussed with the NTLG Losses and CGT Sub-committee.
3.2.	The tax consequences of the final ruling need to be revisited against the original policy intentions covering a wide range of interactions (for example, non-CGT consequences for vendors; CGT consequences for resident vendors who dispose of shares in non-resident companies; CGT and non-CGT consequences for vendors who dispose of units in trusts; capital loss position of the vendor compared to their capital gain position and tax cost base issues for the purchaser).	Policy aspects may be more broadly discussed with the NTLG Losses and CGT Sub-committee.
4.	Amendment of typographical error in paragraph 27	
4.1.	There appears to be a typographical error in paragraph 27 of the draft Ruling which currently states that ‘...Pink proposes to acquire all of the shares in <u>Pink</u> for cash, or for cash and shares in Pink’. <u>[emphasis added]</u> However, from the facts of the example three, the line should read ‘...Pink proposes to acquire all of the shares in <u>Elfin</u> for cash, or for cash and shares in Pink’. <u>[emphasis added]</u>	Agreed. This change has been reflected in paragraph 28 of the final Ruling.
5.	Can a dividend included in capital proceeds under TR 2009/D5 constitute ineligible proceeds under section 124-790? Confirm that there is no requirement that ineligible proceeds be received from the entity that issues the replacement interests.	The ATO considers that this matter is beyond the scope of this Ruling and accordingly has not expanded the final Ruling to cover same.

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Page status: **not legally binding**

Page 6 of 8

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6.	Further explanation or an example showing the calculation of the ineligible part of the cost base of shares in a target company and what will constitute a reasonable attribution under subsection 124-790(2) of the ITAA 1997 where a dividend is included in capital proceeds.	The ATO considers that this matter is beyond the scope of this Ruling and accordingly has not expanded the final Ruling to cover same.
7.	It is submitted that the alternative view as outlined in Appendix 2 of the draft Ruling should be considered as the preferred view adopted by the Commissioner. That is, dividend amounts, even when received by a vendor shareholder under a contract for the sale of shares under a contract or scheme of arrangement, do not form part of the capital proceeds in respect of that disposal.	This alternative argument is addressed by the ATO in Appendix 2 'Alternative views' of the final Ruling.
8.	The draft Ruling appears to be founded on an incorrect interpretation of the majority decision of the case of <i>Chief Commissioner of State Revenue (NSW) v. Dick Smith Electronics Holdings Pty Ltd</i> [2005] HCA 3 (<i>Dick Smith Electronics</i>). The reliance by the Commissioner in <i>Dick Smith Electronics</i> is inconsistent with the reasoning of the High Court in that case. In particular: • in <i>Dick Smith Electronics</i> the dutiable transaction in question was the share sale agreement, and not the subsequent transfer or disposal of the shares for stamp duty purposes. For CGT purposes, income tax is • assessable upon the money or other property received on the disposal of the shares and not on the agreement; • the majority (Gummow, Kirby and Hayne JJ) in <i>Dick Smith Electronics</i> held that the key element of the consideration which moved the • transfer of the shares to the purchaser was the performance by the purchaser of several promises contained in the agreement;	The ATO maintains the view that the position adopted in the draft Ruling is supported by the reasoning of the High Court majority judgement in <i>Chief Commissioner of State Revenue v. Dick Smith Electronics Pty Ltd</i> (2005) 221 CLR 496. As noted in Appendix 2 of the draft Ruling, the reliance section 116-20 places on the occurrence of a CGT event which, in the case of disposal of shares, is considered to be similar to a 'dutiable transaction'. Furthermore, section 104-10 describes CGT event A1 as the disposal of a CGT asset which happens when the contract for the disposal is entered into or, if there is no contract, when the change of ownership occurs. A disposal of shares, in particular one which provides for the sale proceeds to include a dividend, would ordinarily involve and coincide with the execution of a sale contract. Therefore, were the majority reasoning in <i>Dick Smith Electronics</i> to be confined to an agreement, it would nonetheless be appropriate to have recourse to the decision in determining whether the dividend would be included as 'capital proceeds' for CGT purposes.

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Page status: **not legally binding**

Page 7 of 8

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8. cont	- the Federal Court in <i>Lend Lease Custodian Pty Limited v. Deputy Commissioner of Taxation</i> [2006] FCA 1790 dismissed the Commissioner's contention that the same analysis in <i>Dick Smith Electronics</i> applied in an income tax context; - for stamp duty purposes, the NSW Office of State Revenue has limited the application of <i>Dick Smith Electronics</i> to the facts in that case so that duty would apply to a dividend paid to a vendor as part of the consideration under a share sale agreement only where the purchaser is required to fund the company to enable the company to pay the dividend to the vendor. It is submitted that for income tax purposes, the application of <i>Dick Smith Electronics</i> should be similarly limited to the specific facts of that case, that is where the purchaser is required to fund the dividend payment.	The decision of the Federal Court in <i>Lend Lease Custodian Pty Limited v. Deputy Commissioner of Taxation</i> [2006] FCA 1790 primarily centred on whether a right to share in dividends constituted 'property other than money' in the circumstances of that case. It is considered that this decision does not affect the views expressed in the draft Ruling and its links to the <i>Dick Smith Electronics</i> case. Paragraphs 79 and 80 have been inserted into the final Ruling to further address the contentions raised in this issue.
9.	The Commissioner's position in the draft Ruling would give rise to valuation issues in relation to the quantum of capital proceeds to be used in calculating a capital gain or loss on disposal of shares where the dividends paid under a contract of sale or scheme of arrangement are not certain or ascertainable as at the date of the contract.	The ATO disagrees. The draft Ruling does not create its own peculiar valuation issues.
10.	The inclusion of dividends in assessable income and a reduction of capital losses for the dividend amount is contrary to the principle of avoidance of double taxation.	The ATO disagrees. The treatment prescribed in the draft Ruling does not result in double taxation.
11.	The dividends are not received by a vendor shareholder in respect of the disposal of their shares, but rather the dividends are received pursuant to their rights as shareholders of the company.	This alternative argument is addressed by the ATO in Appendix 2 'Alternative views' of the final Ruling.

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Page status: **not legally binding**

Page 8 of 8

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12.	In certain circumstances it may be difficult to determine whether a dividend is declared and paid independently of the disposal which may give rise to considerable uncertainty for taxpayers in determining their taxation obligations.	This issue is primarily a question of fact and no further explanation in the final Ruling is considered appropriate.
13	The proposed retrospective application of the draft Ruling would create considerable uncertainty, unfairness and compliance costs for taxpayers.	Paragraph 40 of the draft Ruling stated that the final Ruling is proposed to apply to years of income both before and after the date of its issue. The Commissioner is required to apply the law and to take a view as to the operation of the law both before and after the issue of the Ruling, which expresses the Commissioner's view as to what the effect of the law has always been. The Commissioner's general views on the system of public rulings following the introduction of the self-assessment amendments to implement the Government's response to the ROSA report are found in Taxation Ruling TR 2006/10: 63. Generally however, public rulings will have both a past and future application because they represent the Commissioner's opinion as to what the correct interpretation of the law has always been. 64. The fact that the Tax Office has not previously publicly stated an interpretative or administrative policy does not mean a public ruling should not have a past application. Even if uncertainty existed previously in an industry, market or among taxation advisers and taxpayers, a public ruling that issued to clarify this uncertainty is to have both a past and future application (subject to the exceptions mentioned in paragraph 62 and 70 of this Ruling). On this basis, retrospective application should apply (subject to the settlement exception noted in paragraph 46 of the final Ruling).