CR 2005/13 - Income tax: return of capital: WMC Resources Limited

Class Ruling

Income tax: return of capital: WMC Resources Limited

Contents Para

Preamble

The number, subject heading, ***What this Class Ruling is about*** *(including* ***Tax law(s)****,* ***Class of persons*** *and* ***Qualifications*** *sections),* ***Date of effect****,* ***Withdrawal****,* ***Arrangement*** *and* ***Ruling*** *parts of this document are a 'public ruling' in terms of Part IVAAA of the* ***Taxation Administration Act 1953****. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Class Ruling are:

- section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- section 136-25 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of WMC Resources Limited ('WMC') who receive the proposed return of capital ('Capital Return') from WMC, which was first announced on 9 December 2004 and which is to be voted on by shareholders on 10 May 2005, and is described in the Arrangement part of this Ruling. In this Ruling, this class of persons are referred to as 'Participating Shareholders'.

4. This Class Ruling does not apply to WMC and does not deal with how the taxation law applies to WMC in relation to the Capital Return. Furthermore, it should be noted that certain in-confidence information relating to the affairs of WMC, but which is not in the public domain, has been taken into account in this Ruling. This information is not disclosed in the Ruling.

Qualifications

5. The Commissioner makes this Ruling based on the precise Arrangement identified in this Ruling.

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the Arrangement described in paragraphs 11 to 26.

7. If the arrangement actually carried out is materially different from the Arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

9. This Class Ruling applies to the income year (as defined in the ITAA 1997) for a Participating Shareholder in which that Shareholder receives the Capital Return. The Arrangement will be completed within that income year. For Participating Shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2005. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2005. This Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement during the term of the Ruling, subject to there being no change in the Arrangement or in the person's involvement in the Arrangement.

Arrangement

11. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for Class Ruling from Deloitte Touche Tohmatsu Ltd, dated 19 November 2004; and
- Further information provided in correspondence from Deloitte Touche Tohmatsu Ltd, dated 1 December 2004, 12 January 2005, 21 January 2005, 1 February 2005, 4 February 2005, 24 February 2005 and 4 March 2005, which included an audited Financial Report for WMC for the financial year ended 31 December 2004.

Note: Certain information from WMC has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

12. On 9 December 2004, WMC announced the Capital Return as part of a broader capital management strategy. This capital management strategy is consistent with an active capital management program agreed to in 2003, encompassing, at appropriate times, dividends, mop-up and top-up share facilities, dividend reinvestment plans and share buy-backs. Additionally, WMC set a target range for dividend payments of between 40 and 60 percent of profit after tax, modified for cash flow, capital commitments and general business conditions, at that time.

13. The capital management strategy announced on 9 December 2004 included the following proposals:

- the payment of the Capital Return totalling $350 million;
- the payment of a final 2004 dividend of $235 million; and
- the undertaking of an on-market buy-back program involving an outlay of $250 million.

14. The payment of the Capital Return is subject to the approval of WMC shareholders, which is to be sought at the WMC Annual General Meeting to be held on 10 May 2005.

15. The Capital Return will be funded by external borrowings.

16. The whole amount of the Capital Return will be debited to WMC's share capital account. WMC has an untainted share capital account.

17. All WMC shareholders who hold ordinary shares ('Shares') on the record date (expected to be 17 May 2005) will receive the Capital Return. The Capital Return made by WMC to Participating Shareholders will be $0.30 per Share. As at 31 December 2004, WMC had approximately 1,172 million Shares on issue.

18. WMC considers its capital management strategy as necessary to increase its gearing ratio to ensure an efficient balance sheet, whilst paying dividends within the parameters of its stated dividend policy. The strategy is a means of ensuring the maximisation of shareholder value. WMC's gearing ratio has fallen significantly below its target level in recent years. The Capital Return is a one-off payment to Participating Shareholders designed to address WMC's present gearing position.

19. As at 31 December 2004, shareholders equity in WMC was equal to approximately $4,308.1 million, of which approximately $3,849.3 million represented share capital and approximately $458.8 million represented retained profits (which figure is prior to the payment of the 2004 final dividend). WMC's share capital has increased by $195.9 million since 31 December 2002 due to the conversion of options, contributions attributable to a dividend reinvestment plan and the issue of shares in relation to a business acquisition. Retained profits in the WMC Group as at 31 December 2004 were approximately $1,257.8 million.

20. At present, WMC Group retained profits that are attributable to WMC subsidiaries are subject to significant impediments and restrictions in relation to their distribution to WMC shareholders. This is due to the application of restrictions by the corporations law and accounting standards that are peculiar to WMC's current circumstances. However, WMC believes that these impediments and restrictions will not impinge on its ability to pay dividends to its shareholders in the future based on future performance in accordance with its stated dividend policy.

21. The following table outlines profit after tax ('PAT') results and retained profit ('RP') outcomes for WMC and the WMC Group since WMC demerged from the broader WMC Ltd Group in 2002. WMC's profit results for 2003 and 2004 include significant one-off non-cash items relating to the application of tax credits.

Year	2002	2003	2004
WMC PAT	($152.5m)	$208.7m	$835.8m
WMC RP	($344.1m)	($110.9m)	$458.8m
Group PAT	($43.7m)	$245.6m	$1,326.9m
Group RP	($77.5m)	$199.5m	$1,257.8m

22. The following table outlines the interim and final dividend payments ($ per share) made by WMC since 2002, including the proposed 2004 final dividend.

Year	2002	2003	2004
Interim	0	0	$0.17
Final	0	$0.06	$0.20

23. These dividend payments fall within the target range of WMC's stated dividend policy. Dividend payments for the 2004 year are at the upper end of this target range.

24. All dividends paid by WMC since 2002 have been unfranked. WMC currently has a nil franking account balance and accordingly is not in a position to frank dividend payments it makes to shareholders.

25. WMC will continue to pay dividends to its shareholders in accordance with its stated dividend policy regardless of whether these dividends are franked or unfranked. Those dividends will be commensurate with profits earned by the company.

26. WMC has a diverse shareholder base, including both resident and non-resident shareholders. As at October 2004, a total of 1.21% of WMC's registered shareholders have an overseas address. As at 12 January 2005, no foreign shareholder had a shareholding in WMC of 10% or more.

Ruling

27. The Commissioner will not make a determination under either subsection 45A(2) or subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Return received by the holders of the Shares.

28. The Capital Return will give rise to CGT event G1 (section 104-135 of the ITAA 1997). The cost base and reduced cost base of each Share in respect of which the Capital Return is made will be reduced (but not below nil) by the amount of the Capital Return (subsections 104-135(3) and (4) of the ITAA 1997). A Participating Shareholder will make a capital gain as a result of CGT event G1 happening in respect of a Share to the extent the amount of the Capital Return exceeds the Share's cost base (subsection 104-135(3) of the ITAA 1997).

29. However, a capital gain is disregarded pursuant to subsection 104-135(5) of the ITAA 1997, if the Participating Shareholder is taken to have acquired the Share before 20 September 1985.

30. A non-resident Participating Shareholder that receives the Capital Return will only make a capital gain if their Shares have the necessary connection with Australia under the tests in section 136-25 of the ITAA 1997. A WMC Share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the Capital Return, the Participating Shareholder together with their associates owned 10% or more by value of the issued shares in WMC.

Explanation

Sections 45A, 45B and 45C of the ITAA 1936

31. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions. If they apply, the Commissioner can make a determination under section 45C of the ITAA 1936 that all or part of a return of capital received by a company's shareholders is treated as an unfranked dividend.

Section 45A

32. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or would receive dividends (the disadvantaged shareholders).

33. WMC will provide Participating Shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936). However, there is nothing in the circumstances of the Capital Return to indicate that there is a 'streaming' of capital benefits to some shareholders who are advantaged shareholders, and dividends to other shareholders, being disadvantaged shareholders, as all Participating Shareholders will receive the Capital Return. Therefore, section 45A of the ITAA 1936 has no application to the Capital Return.

Section 45B

34. Section 45B of the ITAA 1936 applies where certain capital payments, including a return of capital, are made to shareholders in substitution for dividends. 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, 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

35. In the circumstances of the Arrangement, the conditions of paragraphs 45B(2)(a) and (b) are satisfied. The proposed payment of the Capital Return will provide Participating Shareholders with a capital benefit, in respect of which at least a portion of Participating Shareholders would obtain a tax benefit.

36. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the relevant circumstances set out under subsection 45B(8) to determine whether any part of the Arrangement would be entered into or carried out for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

37. The purpose test is an objective one. The question is whether, objectively, it would be concluded that a person who entered into or carried out the scheme (or any part of it), did so for the purpose of obtaining a tax benefit for the relevant taxpayer in respect of the capital benefit. The purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

38. In this regard, the relevant taxpayers are those Participating Shareholders that obtain a tax benefit. After consideration of all the relevant circumstances, the Commissioner, on balance, considers that the requisite purpose for section 45B to apply is not present in this case.

39. In particular, the Commissioner notes that WMC has made or proposes to make dividend payments to its shareholders in accordance with its stated dividend policy and commensurate with profits earned by the company. Further the company is subject to significant restrictions in its ability to currently pay further dividends from WMC Group retained earnings imposed by the corporations law and relevant accounting standards. WMC has indicated that it will continue and not alter the application of its dividend policy, regardless of whether the dividends it pays are franked or unfranked. The application of this dividend policy has seen dividends increased commensurate with profits available for distribution.

40. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the Capital Return.

41. As the Commissioner will not make a determination pursuant to subsection 45B(3) in relation to the Arrangement as described, section 45C will not deem the Capital Return provided to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

Capital Gains Tax

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

42. Subsection 104-135(1) of the ITAA 1997 provides that CGT event G1 happens if:

- a company makes a payment in respect of a share to a shareholder that does not involve CGT event A1 (disposal of a CGT asset) or CGT event C2 (cancellation, surrender and similar endings of a CGT asset) happening; and
- some or all of the payment (the non-assessable part) is not a dividend.

43. Therefore, the Capital Return will give rise to CGT event G1. Subsections 104-135(3) and (4) of the ITAA 1997 together provide that the cost base and reduced cost base of each Share in respect of which the Capital Return is made will be reduced (but not below nil) by the amount of the Capital Return. Subsection 104-135(3) also provides that a Participating Shareholder will only make a capital gain as a result of CGT event G1 happening in respect of a Share to the extent the amount of the Capital Return exceeds the Share’s cost base.

44. However, a capital gain is disregarded pursuant to subsection 104-135(5) of the ITAA 1997 if the Participating Shareholder is taken to have acquired the Share before 20 September 1985.

Necessary connection with Australia – section 136-25 of the ITAA 1997

45. Pursuant to section 136-10 of the ITAA 1997, a non-resident will make a capital gain from the Capital Return only if the non-resident's Shares have the necessary connection with Australia under the tests in section 136-25. Under category 5 of the table in section 136-25 of the ITAA 1997, a WMC Share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the Capital Return, the Participating Shareholder together with their associates owned 10% or more by value of the issued shares in WMC.

Detailed contents list

46. Below is a detailed contents list for this Class Ruling:

Commissioner of Taxation
16 March 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20; TR 97/16

Subject references:

- return of capital on shares
- share capital

Legislative references:

- Copyright Act 1968
- TAA 1953 Pt IVAAA
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(8)
- ITAA 1936 45C
- ITAA 1997 104-135
- ITAA 1997 104-135(1)
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 104-135(5)
- ITAA 1997 136-10
- ITAA 1997 136-25

ATO references

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