


CR 2005/23 - Income tax: return of capital: The Australian Gas Light Company

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Class Ruling

Income tax: return of capital: The Australian Gas Light Company

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax laws, 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 laws' 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 Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - subsection 44(1) of the 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
 - Division 136 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies are the ordinary shareholders in The Australian Gas Light Company (AGL) who will receive a return of capital as described in the Arrangement part of this Ruling. In this Ruling they are referred to as 'participating shareholders'.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. 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 10 to 23.
6. 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 - this Ruling may be withdrawn or modified.
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Date of effect

8. This Class Ruling applies to the income year (as defined in the ITAA 1997) for a participating shareholder in which that shareholder receives the return of capital. 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

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 This Class Ruling is withdrawn and ceases to have effect after 30 June 2005.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

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents:

- the Class Ruling application authored by Greenwoods & Freehills and dated 18 November 2004;
- the AGL financial statements for the financial years 2002 to 2004;
- the AGL NZ Limited financial statements for the financial years 2002 to 2004;
- the financial statements for a partly-owned subsidiary for the financial years 2002 to 2004;
- the letters dated 24 September 2004 and 8 October 2004 from AGL providing additional information. These letters related to an earlier class ruling application that was subsequently withdrawn. The Class Ruling application dated 18 November 2004 confirmed that this information should be included with this application; and
- Greenwoods and Freehills email of 17 December 2004 providing additional information.

These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description.

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

11. AGL is a widely held public company and its shares are listed on the Australian Stock Exchange. AGL has a market capitalisation exceeding \$5.7 billion as at 10 August 2004.

12. Shareholders of AGL are a mix of resident individuals, companies and superannuation funds and non-resident investors.

13. AGL pays ordinary dividends semi-annually and in the last five years these dividends have been in the range of \$0.21 to \$0.29 per share and were partially franked. An unfranked special dividend of \$0.23 was paid in October 2000.

14. AGL's gearing levels have reduced significantly in recent years as a result of:

- lower capital expenditures on internal projects and acquisitions;
- divestment of various businesses; and
- the historically strong take-up of the AGL dividend re-investment plan.

15. AGL now has capital in excess of its requirements.

16. AGL is seeking to restore its gearing to an optimal, commercially acceptable level and has decided upon the proposed return of capital as a means of achieving this.

17. AGL publicly announced on 26 August 2004 its intention to engage in capital management activities.

18. Subject to shareholder approval, AGL proposes to make a return of capital of \$0.50 per share to all of its shareholders. The total capital to be returned is in the amount of approximately \$227 million. The return of capital will be debited entirely to AGL's share capital account.

19. The capital that AGL is proposing to return to shareholders relates to recent equity issuance under the dividend reinvestment plan and a return of capital received from a partly-owned subsidiary.

20. It is not possible to predict the amount of cash at bank AGL will hold at the time the arrangement is implemented. However, it is expected that the arrangement will be funded using general working capital and existing bank loans.

21. AGL does not intend to change its dividend policy as a result of the arrangement. That is, AGL intends to continue its policy of paying semi-annual, partially franked dividends of comparable amounts following payment of the return of capital.

22. AGL confirms that its share capital account, as defined in section 6D of the ITAA 1936, is not tainted as there have been no transfers to the share capital account from other accounts.

23. A participating shareholder retains their right to be paid the return of capital amount even if they disposed of their share after the record day – the entitlement to the payment does not pass with the transfer of an ordinary share.

Ruling

24. All references are to the ITAA 1936 unless otherwise specified.

Dividends

25. The return of capital of \$0.50 per share under the Arrangement is not a 'dividend' as defined by subsection 6(1) and therefore it would not be included in shareholders' assessable income under section 44.

Anti-avoidance provisions

26. The Commissioner will not make a determination under either subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole, or any part, of the return of capital received by the shareholders.

Capital gains tax consequences

27. CGT event G1 in section 104-135 of the ITAA 1997 will happen when AGL pays the return of capital to a participating shareholder in respect of a share they own at the payment date. CGT event C2 in section 104-25 of the ITAA 1997 will happen when a participating shareholder receives the return of capital in respect of a share they no longer own at the payment date. CGT event C2 happens because the participating shareholder's right to the payment is satisfied by the payment.

28. If CGT event G1 happens in respect of a share, then its cost base and reduced cost base will be reduced (but not below nil) by the payment amount (subsections 104-135(3) and (4) of the ITAA 1997). Also, a participating shareholder will make a capital gain in respect of the share to the extent that the payment exceeds the share's cost base (subsection 104-135(3) of the ITAA 1997).

29. If CGT event C2 happens in respect of a participating shareholder's right to the payment they will make a capital gain to the extent the payment exceeds the cost base of the right. They will make a capital loss to the extent the payment is less than the right's reduced cost base. See subsection 104-25(3) of the ITAA 1997.

30. A capital gain made by a participating shareholder under CGT event G1 or a capital gain or loss made under CGT event C2 will be disregarded if the share in respect of which the payment was made was acquired before 20 September 1985.

31. A non-resident shareholder will only make a capital gain or loss as a result of the return of capital if the relevant asset has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Explanation

Dividends

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

33. The term 'dividend' defined in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, the ambit of this is confined by later paragraphs in the definition which exclude certain items from being a dividend for income tax purposes.

34. Relevantly, the specific exclusion in paragraph (d) of the definition of dividend provides:

moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4)), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

35. The return of capital will be debited against AGL's untainted share capital account. Therefore, paragraph (d) of the definition of 'dividend' applies and the return of capital would not constitute a dividend unless some other more specific provision of the Income Tax Assessment Acts (ITAA 1936 or ITAA 1997) operate to make it a dividend.

Anti-avoidance provisions

Sections 45A and 45B

36. Sections 45A and 45B are anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C that all or part of the return of capital is treated as an unfranked dividend.

Section 45A

37. 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.

38. Although AGL will be providing its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), the capital benefit is to be provided to all of the shareholders in AGL. The circumstances of the Arrangement do not indicate that there is a 'streaming' of capital benefits to advantaged shareholders and dividends to disadvantaged shareholders. Accordingly, section 45A has no application to the proposed payment of the return of capital.

Section 45B

39. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. Specifically, the provision 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, 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 the scheme 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 to obtain a tax benefit (paragraph 45B(2)(c)).

40. In the circumstances of the Arrangement, the conditions of paragraphs 45B(2)(a) and (b) are satisfied, as the proposed payment of the return of capital will provide shareholders with a capital benefit (as defined in subsection 45B(5)). This is because shareholders generally pay less tax on return of capital amounts than they do on an equivalent amount of dividend (a 'tax benefit' as defined in subsection 45B(9)).

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

42. The test of purpose is an objective one. The question is whether, objectively, it would be concluded that a person who entered into or carried out the scheme, 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.

43. In this regard, the relevant taxpayers are the shareholders of AGL. The relevant circumstances of this arrangement are:

- AGL is able to demonstrate surplus capital in excess of its requirements and has identified the amount of the return of capital as being attributable to recent equity issuance under the dividend reinvestment plan and a return of capital received from a partly-owned subsidiary. AGL expects to fund the distribution from general working capital and existing bank loans. This is supportive of a conclusion that no part of the return of capital will be attributable to specific profits, realised or unrealised, of AGL or any of its subsidiaries (paragraph 45B(8)(a));
- over the last 5 years, ordinary dividends paid by AGL have generally been in the range of \$0.21 to \$0.29 per share. AGL intends to continue with its current dividend policy following the payment of the return of capital. These factors are supportive of a conclusion that the return of capital is not in substitution for a dividend (paragraph 45B(8)(b));
- AGL is a listed public company with a wide range of shareholders being a mix of individuals, companies, institutional investors and non-residents. AGL estimates the percentage of non-resident investors to be approximately 2.18%. The tax profile of the current shareholders is not known by AGL, but this is not considered to be a material factor as the return of capital will be paid to all shareholders (paragraphs 45B(8)(c), (d), (e) and (f));
- paragraphs 45B(8)(g), (i) and (j) are not relevant to AGL's proposed return of capital;
- the comparative rights and interests held by the shareholders after the return of capital will be the same as those that would have been held had an equivalent dividend been paid instead of the capital benefit (paragraph 45B(h)); and
- the matters referred to in paragraph 45B(8)(k) are the relevant circumstances listed in subparagraph 177D(b)(i) to (viii) in relation to the arrangement for the purpose of determining whether a scheme was entered into to obtain a tax benefit under Part IVA. In the present circumstances, the return of capital will apply to all shareholders of AGL equally. The form and substance of AGL's proposed return of capital does not lead to a view that the arrangement was entered into for the purpose of obtaining such a tax benefit.

44. Having regard to the circumstances outlined in paragraph 43, it is considered that the arrangement as described will not be entered into for the purpose, not being an incidental purpose, of enabling a shareholder of AGL to obtain a tax benefit. Although a tax benefit would be provided to the shareholders of AGL, any benefit is merely incidental. It is accepted the purpose of the proposed return of capital is to return capital surplus to AGL's present requirements to its shareholders.

45. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the return of capital.

46. 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 return of capital provided to be an unfranked dividend for the purposes of ITAA 1936 or ITAA 1997.

Capital gains tax consequences

47. All shareholders at the record date are entitled to the return of capital. They retain their right to payment even if they dispose of their shares between the record and payment dates. That is, the right remains with the shareholder as at the record date and does not pass with the shares to the new owner.

48. Therefore, the capital gains tax consequences depend on whether the participating shareholder still holds the shares at the payment time.

Participating shareholder continues to own shares – G1 event

49. CGT event G1 will happen when AGL pays the return of capital amount in respect of a share that a shareholder owned at the record time and continues to own at the payment time.

50. If the return of capital amount (\$0.50 per share) is not more than the cost base of the AGL share at the time of the payment, the cost base and reduced cost base of the share are reduced by the amount (subsection 104-135(4) of the ITAA 1997).

51. A participating shareholder will make a capital gain if the return of capital amount is more than the cost base of their AGL share. The amount of the capital gain is equal to this excess. However, the capital gain is disregarded if the share was acquired before 20 September 1985 (subsection 104-135(5) of the ITAA 1997).

52. If a shareholder makes a capital gain, the cost base and reduced cost base of the share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

53. A participating shareholder cannot make a capital loss under CGT event G1.

Participating shareholder has disposed of shares – C2 event

54. If a participating shareholder has ceased to own some, or all, of their shares in AGL in respect of which a return of capital amount is paid, the right to the payment is considered to be a separate CGT asset. This is because the right to the payment has been separated from the bundle of rights that once attached to the share.

55. A participating shareholder's right to receive the payment will be discharged or satisfied when the payment is made under the arrangement, causing CGT event C2 to happen.

56. In working out the capital gain or capital loss made from CGT event C2 happening, the capital proceeds from the event will be the return of capital amount.

57. The cost base of the participating shareholder's right to receive a payment under the arrangement is worked out in accordance with Division 110 of the ITAA 1997. However, the cost base of the right will be nil if the full cost base (or reduced cost base) of the share previously held by the participating shareholder has been applied in working out a capital gain or loss when a CGT event happened to the share – for example, when the participating shareholder disposed of the share. In these cases, the participating shareholder will generally make a capital gain equal to the amount paid under the arrangement.

58. Because the right to a payment such as the return of capital was inherent in the share during the time it was owned then, for the purposes of Subdivision 109-A of the ITAA 1997, the right is considered to have been acquired at the time when the share was acquired.

59. Consequently, if the share to which the payment relates was originally acquired by a participating shareholder at least 12 months before the payment of the return of capital amount, a capital gain from CGT event C2 happening to the right may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

60. Any capital gain or loss from CGT event C2 will be disregarded if the share in respect of which the payment was made was acquired before 20 September 1985 (paragraph 104-25(5)(a) of the ITAA 1997).

Division 136

61. A non-resident shareholder will only make a capital gain or loss as a result of the return of capital if the relevant asset has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Detailed contents list

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Commissioner of Taxation

20 April 2005

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Previous draft:

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Related Rulings/Determinations:

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

Subject references:

- capital benefit
- dividend
- dividend substitution
- return of capital

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44
- ITAA 1936 44(1)
- 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(5)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(c)
- ITAA 1936 45B(8)(d)
- ITAA 1936 45B(8)(e)
- ITAA 1936 45B(8)(f)
- ITAA 1936 45B(8)(g)
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(i)
- ITAA 1936 45B(8)(j)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 Pt IVA
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
- ITAA 1936 177D(b)(iii)
- ITAA 1936 177D(b)(iv)
- ITAA 1936 177D(b)(v)
- ITAA 1936 177D(b)(vi)
- ITAA 1936 177D(b)(vii)
- ITAA 1936 177D(b)(viii)
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-25(5)(a)
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 104-135(5)
- ITAA 1997 Subdiv 109-A
- ITAA 1997 Div 110
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 Div 136
- ITAA 1997 136-10
- TAA 1953 Pt IVA
- Copyright Act 1968

ATO references

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