



# ***CR 2005/45 - Income tax: capital reduction: CSR***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2005*



## Class Ruling

### Income tax: capital reduction: CSR

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#### **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 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:

- 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 136-10 of the ITAA 1997.

#### **Class of persons**

3. The class of persons to which this Ruling applies is the ordinary shareholders of CSR Limited who receive distributions under the proposed capital reduction described in paragraphs 10 to 15.

#### **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 15.

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- this Ruling may be withdrawn or modified.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

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8. This 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 2006. 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 inconsistent later public ruling; or
- the relevant tax laws are not amended.

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## Withdrawal

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9. This Class Ruling is withdrawn and ceases to have effect immediately after 30 June 2006. 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, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

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## Arrangement

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10. The Arrangement that is the subject of the Ruling is described below. This description is based on a number of 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 are:

- a) Class Ruling request dated 15 September 2004;
- b) correspondence dated 16 November 2004; and
- c) e-mails dated 27 October 2004, 2 February 2005, 4 February 2005, 10 February 2005, 15 March 2005, 22 March 2005, 23 March 2005, 14 April 2005 and 28 April 2005.

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

11. CSR Ltd is an Australian resident public company listed on the Australian Stock Exchange (ASX) and the ultimate parent of the CSR group. The CSR group as presently constituted was created in March 2003 following the demerger of the Rinker group which then listed separately on the ASX. The CSR group carries on three main businesses producing building materials, aluminium and sugar. The CSR group joined the consolidation tax regime as a single entity from 1 April 2004.

12. The Board of CSR Ltd proposes to return share capital of 20 cents per share to the shareholders of CSR Ltd, totalling approximately \$182.1 million. The amount will be debited against the share capital account of CSR Ltd which has credited to it only paid up share capital and is therefore not 'tainted' as that term is defined in subsection 160ARDM(1) of the ITAA 1936. The capital return will be funded from existing external debt facilities acquired to fund capital acquisitions which were not ultimately proceeded with.

13. The capital return is subject to shareholder approval at the Annual general Meeting of CSR Ltd to be held on 14 July 2005. All the shareholders of CSR Ltd registered on the Record Date will be entitled to the return of capital. The Record Date is expected to be 21 July and the capital return will be paid subsequent to that date.

14. As at 31 March 2005 CSR Ltd had 910.4 million shares on issue with paid up capital of \$863.7 million. The capital return represents approximately 21% of the issued capital and will apply equally to all shareholders. In relation to the 2005 income year, in addition to the capital return, an ordinary interim dividend of 6 cents per share (approximately \$55.11 million) was paid on 3 December 2004, and a final dividend of at least 6 cents per share is to be paid post income year's end.

15. The purpose of CSR Ltd in making the Capital Return is to achieve the following commercial objectives:

- a) to increase its gearing to more appropriate levels and thereby reduce the Weighted Average Cost of Capital (WACC);
- b) to remove the adverse impact on the share price which arises from the market perception that a low gearing reflects inefficient capital management and could lead to poor investment decisions; and
- c) to take advantage of part of a significant existing debt facility.

## Ruling

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16. The Commissioner will not make a determination (under sections 45A or 45B of the ITAA 1936) that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Reduction Amount received by the holders of CSR ordinary shares.

17. Section 104-135 will apply to shareholders in respect of the return of capital.

18. Non-resident shareholders who receive the capital return will make no capital gains pursuant to section 136-10 of the ITAA 1997, provided the non-resident shareholder (and its associates) beneficially owned less than 10% by value of the shares during the 5 years before the capital return.

## Explanation

### **Sections 45A and 45B of the ITAA 1936**

19. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfrankable dividend that is paid by the company out of profits to the shareholder.

### **Section 45A – streaming of dividends and capital benefit**

20. Section 45A of the ITAA 1936 applies in circumstances where capital benefits and dividends 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 (the disadvantaged shareholders) have received or would receive dividends.

21. CSR Ltd will provide all of its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) and all shareholders will receive the same amount of return of capital per share. In these circumstances, there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Therefore, section 45A of the ITAA 1936 does not apply to the return of capital.

### **Section 45B – schemes to provide capital benefits in substitution for dividends**

22. Section 45B of the ITAA 1936 applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

23. Subsection 45B(2) sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies. These conditions are that:

- there is a scheme under which a person is provided with a capital benefit by a company;
- 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; and
- 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 the relevant taxpayer to obtain a tax benefit.

Each of the conditions is considered below.

24. The return of capital is a 'scheme' within the broad meaning of that term.

25. The phrase 'provided with a capital benefit' is defined at subsection 45B(5) of the ITAA 1936. Relevantly, it includes a distribution to a person of share capital. As CSR Ltd proposes to debit the return of capital against its untainted share capital account, its shareholders will be provided with a capital benefit.

26. A taxpayer 'obtains a tax benefit', as defined in subsection 45B(9) of the ITAA 1936, where:

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

by the taxpayer would, apart from the operation of section 45B:

- be less than the amount that would have been payable; or
- be payable at a later time than it would have been payable,

if the capital benefit had been a dividend.

27. 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. A capital gain may not arise at all for certain non-resident shareholders: see paragraph 40. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or, in the case of a non-resident, subject to dividend withholding tax. Therefore, the shareholders will obtain tax benefits from the capital return.

28. The Commissioner is required to consider the 'relevant circumstances' set out under subsection 45B(8) of the ITAA 1936 to determine whether any part of the scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit. However, the list of relevant circumstances in subsection 45B(8) is not exhaustive and regard may be had to other circumstances on the basis of their relevance.

29. 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 requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

30. 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 CSR Ltd. The Commissioner cannot at this stage apprehend the purposes of CSR's numerous shareholders all of whom are eligible to vote on the capital reduction under section 256C of the *Corporations Act 2001* and all of whom would participate in the return of capital should the proposal be approved. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company should, generally speaking, not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who vote in favour of the proposal.

31. The relevant circumstances under subsection 45B(8) cover the circumstances of the company and the tax profile of the shareholders. In this instance, as the capital return is made to all shareholders of CSR Ltd regardless of individual circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(i) and (j) pertaining to the provision of ownership interests and demerger respectively are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

32. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or an associate (within the meaning of section 318 of the ITAA 1936) of the company. In this case, the capital return is referable to the replacement of share capital in the company's operations with debt facilities acquired to fund capital acquisitions that did not go ahead. The existence of the debt facilities has enabled CSR Ltd to pursue an optimum gearing ratio by increasing debt and reducing equity to the extent proposed. Whilst the reduction in equity is achievable by distributing either capital or profit, the company's preference to retain profit and return capital is based on and consistent with its dividend strategy of the past thirteen years. In these circumstances, the capital benefit is attributable to capital not profits, realised or unrealised.

33. 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. CSR Ltd proposes to maintain its dividend payout ratio of the past 13 years and to ensure that the amount of dividends will not be reduced. Also, in order to remain competitive in relation to its annual return to shareholders, the company has, since 1992 year when it experienced a general downturn in business, maintained a constant level of retained earnings relative to annual distributions as a buffer against such a downturn. Furthermore, apart from the occasion of the demerger of the Rinker group, which involved the distribution to shareholders of both profit and capital, CSR Ltd has not returned share capital to its shareholders. The pattern of distributions made by CSR Ltd does not suggest that the capital return is made in substitution for a dividend.



34. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (viii) of the ITAA 1936. 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. CSR Limited has demonstrated objectively that the scheme, a return of capital to the shareholders, is timed to take advantage of the existence of committed borrowing facilities to improve the company's debt to equity ratio and hence reduce its weighted average cost of capital. In turn, this should result in more profit from the company's various projects, a higher rate of return to the shareholders on their investment in the company and upward pressure on the share price. In this case, the practical implications of the scheme are consistent with its being, in form and substance, a distribution of share capital.

35. Therefore, having regard to the relevant circumstances of the scheme to return capital to the shareholders of CSR Ltd, as discussed in paragraphs 28 to 34, it would not be concluded that CSR Ltd enters into or carries out the scheme for a more than incidental purpose of enabling the shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the capital return.

#### **Section 45C – deeming dividends to be paid where determinations under sections 45A or 45B are made**

36. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 in relation to the arrangement as described, section 45C will not apply.

#### **CGT Event G1: section 104-135**

37. CGT Event G1 (section 104-135 of the ITAA 1997) occurs if a company makes a payment to a shareholder in respect of a share they own in the company and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

38. CSR Ltd proposes to make a payment to its shareholders out of its share capital account. This payment will not be a dividend as the term is defined in subsection 995-1(1). The provisions referred to in that definition are not applicable. Furthermore, the capital return will not be taken to be a dividend under section 47 which applies to distributions made by liquidators. Accordingly, CGT event G1 will occur.

39. Pursuant to subsections 104-135(3) and (4), the cost base and reduced cost base of each CSR Ltd share will be reduced (not below nil) by the amount of the capital return. Capital gains can also arise from CGT event G1 but only to the extent (if any) that the payment exceeds the share's cost base: subsection 104-135(3).

**Non-resident shareholders: Division 136**

40. If the shareholder is not an Australian resident for income tax purposes, a CGT event G1 capital gain cannot be made unless the shares have the necessary connection with Australia in terms of section 136-25 of the ITAA 1997. Broadly, shares in public companies will not have the necessary connection with Australia, and a capital gain or a capital loss will not be made, where the non-resident shareholder and their associates beneficially own less than 10% by value of the shares in the company during the 5 years before the CGT event.

**Detailed contents list**

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

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# CR 2005/45

*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:*

- capital reduction
- reduction of share capital
- return of share capital
- share capital

*Legislative references:*

- TAA 1953 Pt IVAAA
- Copyright Act 1968
- Corporations Act 2001 256C
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)
- 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 47
  - ITAA 1936 160ARDM(1)
  - ITAA 1936 177D(b)(i)
  - ITAA 1936 177D(b)(ii)
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  - ITAA 1936 177D(b)(vii)
  - ITAA 1936 177D(b)(viii)
  - ITAA 1936 318
  - ITAA 1997 104-135
  - ITAA 1997 104-135(3)
  - ITAA 1997 104-135(4)
  - ITAA 1997 136-10
  - ITAA 1997 136-25
  - ITAA 1997 995-1(1)
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ATO references

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