

CR 2005/96 - Income tax: return of capital: New Hope Corporation Limited

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Class Ruling

Income tax: return of capital: New Hope Corporation Limited

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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 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; and
- section 136-10 of the ITAA 1997.

Class of persons

3. The class of persons to which this Class Ruling applies is all ordinary shareholders of New Hope Corporation Limited (New Hope), who are registered on the New Hope share register on the Record Date and who participate in the arrangement described in this Ruling.

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 17.

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- this Ruling may be withdrawn or modified.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 subsection 995-1(1) of the ITAA 1997) ending 30 June 2006. The arrangement will be completed within that income year. 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 Ruling is withdrawn and ceases to have effect 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 arrangements 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

10. The arrangement that is the subject of the 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 arrangement are:

- Class Ruling request from PricewaterhouseCoopers (PWC), dated 1 September 2005; and
- Correspondence from PWC dated 29 September 2005 and 21 October 2005.

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

11. New Hope is an Australian resident company listed on the Australian Stock Exchange (ASX). It is engaged in integrated coal mining operations, handling and trading. New Hope shareholders are a mix of individuals, companies, institutional investors and foreign residents. New Hope estimates the percentage of foreign resident shareholders to be approximately 13%. As at the Record Date, it has approximately 800 million ordinary shares on issue, and no other types of issued equity.

12. In June 2005, New Hope sold its international coal assets. For a number of business reasons it had been decided to capitalise on the current strong coal prices and realise the value in these assets. New Hope intended to return a proportion of the net proceeds received from these sales to its shareholders by way of a return of capital. New Hope had engaged in specific capital raisings to acquire and improve its international coal assets.

13. New Hope had also provided the international coal assets with additional funds via various loan facilities which were then used to fund the respective business operations.

14. Following the sale of these assets, New Hope determined that it had capital surplus to its requirements and based its calculations for the return of capital on the amount of shareholders' capital that had been invested in acquiring these assets.

15. On 27 September 2005, New Hope announced that it would return the capital its shareholders had subscribed for the investment in the international assets. The whole of the capital return will be debited against its share capital account with an expected payment date on or about 16 December 2005. The return of capital is expected to be 10 cents per share.

16. New Hope also proposes to pay an initial special dividend of approximately \$100 million (representing 13 cents per share) to be paid out of the profits on the sale representing a return to the shareholders of a portion of the profit realised on the sale of international coal assets.

17. New Hope 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.

Ruling

18. As the return of capital will be debited to New Hope's untainted share capital account, it will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

19. The Commissioner will not make a determination under subsections 45A(2) or 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the return of capital. Accordingly, no part of the return of capital will be taken to be a dividend for income tax purposes.

20. CGT Event G1 will happen when the return of capital is paid to the New Hope shareholders (subsection 104-135(2) of the ITAA 1997).

21. CGT Event C2 (section 104-25 of the ITAA 1997) will happen to a New Hope shareholder receiving the return of capital who ceases to own their New Hope shares after the record date but before the return of capital.

22. A foreign 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

Dividend

23. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income a dividend, as defined by subsection 6(1) of the ITAA 1936, which is paid to the shareholder out of company profits.

24. As the return of capital will be debited against an amount standing to the credit of New Hope's untainted share capital account, it does not constitute a dividend because of the exclusion in paragraph (d) in the definition of a 'dividend' in subsection 6(1) of the ITAA 1936. That paragraph excludes a distribution from the meaning of 'dividend' if the amount of a distribution is debited against an amount standing to the credit of the company's share capital account.

Sections 45A and 45B of the ITAA 1936

25. 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 to be treated for tax purposes as an unfranked dividend paid by the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

26. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to advantaged shareholders who would, in the year of income in which the capital benefits are provided, derive a greater benefit than the other shareholders (the disadvantaged shareholders) who would receive a dividend.

27. New Hope will be providing its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), and the capital benefit is to be provided to all shareholders in direct proportion to their shareholding. As all shareholders benefit equally from the return of capital, there is no indication of 'streaming' capital benefits to some shareholders and not to others. Accordingly, section 45A of the ITAA 1936 will not apply to the return of capital, and the Commissioner will not make a determination under subsection 45A(2) that section 45C of the ITAA 1936 applies to the return of capital.

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

28. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. 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.

29. Therefore, the following elements need to be satisfied before section 45B of the ITAA 1936 will apply to the arrangement:

- The return of capital is a scheme for the purposes of section 45B.
- The shareholders will be 'provided with a capital benefit' as defined in section 45B(5) of the ITAA 1936 by New Hope under the proposed return of capital. The definition includes a distribution of share capital.
- The shareholders will obtain a tax benefit under the arrangement.

30. The shareholder '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 instead been a dividend.

31. Ordinarily, a return of capital would be subject to the capital gains tax (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 foreign resident shareholders: see paragraph 45 of this Ruling. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or, in the case of a foreign resident, be subject to dividend withholding tax. Therefore, shareholders will generally obtain a tax benefit by receiving the distribution as a return of capital as compared to a dividend of the same amount.

Relevant circumstances

32. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the circumstances set out under subsection 45B(8) of the ITAA 1936 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.

33. This 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.

34. In this case, the relevant taxpayers are the shareholders of New Hope. The relevant circumstances of this arrangement are:

- New Hope is able to demonstrate capital in excess of its requirements and has identified the amount of the proposed return of capital as being the approximate proportion of the New Hope shareholders' capital invested in the international coal assets sold. This is supportive of a conclusion that no part of the return of capital will be attributable to specific profits, realised or unrealised, of New Hope or any of its subsidiaries (paragraph 45B(8)(a) of the ITAA 1936);
- over the last three years New Hope has regularly paid dividends and intends to continue with its current dividend policy of paying semi-annual dividends following the payment of the return of capital. New Hope also proposes to pay an initial special dividend of approximately \$100 million to be paid out of the profits on the sale representing a return to the shareholders of a portion of the profit realised on the sale of international coal assets. These factors are supportive of a conclusion that the proposed return of capital will not be in substitution for a dividend (paragraph 45B(8)(b));
- New Hope is a listed public company with a range of shareholders being a mix of individuals, companies, institutional investors and foreign residents. New Hope estimates the percentage of foreign resident shareholders to be approximately 13%. The tax profile of the shareholders 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 New Hope'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(8)(h)); and
- the matters referred to in paragraph 45B(8)(k) are the relevant circumstances listed in subparagraph 177D(b)(i) to (viii) of the ITAA 1936 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 New Hope equally. The form and substance of New Hope'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.

35. Having regard to the circumstances outlined in paragraph 34, 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 New Hope to obtain a tax benefit.

36. Although a tax benefit will be provided to the shareholders of New Hope, any benefit is merely incidental. It is accepted the purpose of the proposed return of capital is to return capital surplus to New Hope's present requirements to its shareholders.

37. Accordingly, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the return of capital.

38. As the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 or subsection 45B(3) of the ITAA 1936 in relation to the arrangement as described, section 45C will not deem any part of the return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

CGT event G1

39. CGT event G1 (section 104-135 of the ITAA 1997) happens if a company makes a payment to a shareholder in respect of their shares in the company and some or all of that payment is not a dividend or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

40. A shareholder will make a capital gain if the return of capital by the company in relation to a share exceeds the cost base of the share (subsection 104-135(3) of the ITAA 1997).

41. The cost base and reduced cost base of each New Hope share will be reduced (but not below nil) by the amount of the return of capital (subsections 104-135(3) and (4) of the ITAA 1997). As the return of capital is expected to be 10 cents per share, it is not likely to result in any capital gains for New Hope shareholders.

CGT event C2

42. A person who is a registered ordinary shareholder of New Hope on the record date for the proposed return of capital acquires the right to receive the capital return on that date. A shareholder continues to have the right to the capital return even if the shareholder ceases to own the shares before the payment is made. The right is a CGT asset separate from the New Hope share.

43. CGT event C2 will happen (section 104-25 of the ITAA 1997) when the return of capital is paid, and the right to the payment ends. A capital gain will result if the capital proceeds for the event are more than the cost base of the right. The capital proceeds will be the amount of the payment from New Hope. As no amount will have been paid for the right, its cost base is likely to be nil. Therefore a capital gain equal to the payment will arise.

44. As the right to payment from the company was inherent in the share during the time that it was owned, the right is considered to have been acquired at the time the share was acquired. If the share was originally acquired by the former shareholder at least twelve months before the date of the payment, a capital gain from the right may qualify as a discount capital gain (subsection 115-25(1) of the ITAA 1997) if the other conditions in subdivision 115-A of the ITAA 1997 are satisfied.

Division 136

45. A foreign resident shareholder will not make a capital gain in respect of shares in an Australian company unless the shares have the necessary connection with Australia (section 136-10 of the ITAA 1997).

46. Section 136-25 of the ITAA 1997 sets out the categories of assets that may be treated as having the necessary connection with Australia. In relation to shares in an Australian company, the relevant requirements are contained in item 5 of section 136-25 of the ITAA 1997.

47. Relevantly, a foreign resident shareholder and its associates must have (at any time during the 5 years immediately before the capital return) held at least 10% by value of the shares in order for the shares to have the necessary connection with Australia.

Detailed contents list

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Commissioner of Taxation

16 November 2005

Previous draft:

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Related Rulings/Determinations:

CR 2001/1; CR 2003/105;
 CR 2004/153; CR 2005/23;
 TR 92/1; TR 92/20; TR 97/16

Subject references:

- return of capital on shares
 - share capital

Legislative references:

- TAA 1953 Pt IVA
 - ITAA 1936 6(1)
 - ITAA 1936 6D
 - ITAA 1936 44(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)(b)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)
 - 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)(k)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1936 47
 - ITAA 1936 177D(b)(i)
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 - 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 104-135
 - ITAA 1997 104-135(2)
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-135(4)
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25(1)
 - ITAA 1997 Div 136
 - ITAA 1997 136-10
 - ITAA 1997 136-25
 - ITAA 1997 995-1(1)
 - Copyright Act 1968

Other references:

- ATO ID 2003/6
 - ATO ID 2003/1137

ATO references

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