


CR 2007/79 - Income tax: return of capital: Ramelius Resources Limited

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Class Ruling

Income tax: return of capital: Ramelius Resources Limited

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 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 855-10 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Ramelius Resources Ltd (RMS) who are registered on the RMS share register on the Record Date, being the date for determining entitlements to the return of capital and who receive distributions under the return of capital as described in the Scheme in paragraphs 13 to 29 of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in the Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 29 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

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

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Date of effect

8. This Ruling applies from 1 July 2007 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

9. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

13. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- Class Ruling application from Kennedy & Co dated 18 May 2007;
- correspondence providing further information dated 24 May 2007 and 14 June 2007 from Kennedy & Co;
- copies of RMS' annual reports for the 2003-2006 income years;
- copy of RMS' consolidated half year financial report as at 31 December 2006; and
- notice and explanatory memorandum provided to shareholders dated 18 May 2007 for the general meeting held on 28 June 2007 for the return of capital.

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

14. RMS is a gold and minerals exploration and mining company which listed on the Australian Stock Exchange on 31 March 2003.

15. RMS' shareholders are a mix of individuals, companies, superannuation funds and foreign residents.

16. On 31 May 2007, RMS had 107,731,636 shares on issue. RMS also had on issue options exercisable by 30 June 2007 (quoted on the ASX as RMSOA options) and options exercisable by 31 December 2007 (quoted on the ASX as RMSO options).

17. As part of RMS' capital management program, the directors of RMS have identified that the funds received from the exercise of the options are excess to the requirements of the company. Although RMS anticipated a requirement for these funds at the time of their issue, the success of exploration and mining activities could not be anticipated.

18. The directors of RMS believe that the return of capital will not prejudice the company's ability to meet its obligations or implement its business plans.

19. The Directors have proposed that the capital return will take place on 30 September 2007.

20. RMS proposes to make a return of capital of 7.5 cents per share based on the number of shares on issue at the Record Date (3 August 2007).

21. RMS has advised that, at 31 May 2007, there were 53 non-resident shareholders (approximately 1.95%) holding shares which represent 3.1% of the issued capital.

22. The return of capital was approved at a General Meeting held on 28 June 2007.

23. At the Record Date, RMS had 159,677,527 ordinary shares on issue which were held by approximately 2,952 shareholders. The return of capital will be by way of an equal reduction of 7.5 cents per ordinary share, amounting to \$11.9 million which will be debited to the share capital account.

24. RMS has not paid dividends in the past. It has paid a maiden dividend of 0.5 cents per share on 3 August 2007 and does not anticipate paying another dividend during the year ending 30 June 2008.

25. RMS had retained earnings of \$3.2 million at 31 December 2006. This is insufficient to pay the expected return of capital of \$11.9 million.

26. The return of capital is to be funded using cash reserves and will be debited against RMS' share capital account.

27. In addition RMS has announced that it will make a one for ten issue of Bonus options exercisable at \$1.00 by 30 June 2009.

28. As a result of the return of capital there will be no change in either the number of ordinary shares held by each RMS shareholder or the proportionate interest of each shareholder in RMS.

29. RMS confirms that its share capital account as defined in section 975-300 of the ITAA 1997 is untainted.

Ruling

Distribution is not a dividend

30. As the return of capital has been debited to RMS' untainted share capital account, it will not be a dividend as defined in subsection 6(1).

Distribution will not be deemed a dividend under section 45C

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

Capital gains tax

32. CGT event G1 will happen when RMS pays the return of capital to an RMS shareholder in respect of an RMS share that they own at the time of the payment (section 104-135 of the ITAA 1997).

33. CGT event C2 will happen when RMS pays the return of capital to an RMS shareholder in respect of an RMS share they owned at the Record Date but which they ceased to own before the time of the payment (section 104-25 of the ITAA 1997).

Foreign resident shareholders

34. For a foreign resident shareholder, the payment of the return of capital will only have CGT consequences if their RMS shares are 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

22 August 2007

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Distribution is not a dividend

35. 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 the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

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

37. Relevantly, paragraph (d) specifically excludes from the definition of 'dividend':

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.

38. 'Share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

39. Subsection 975-300(3) of the ITAA 1997 states that an account is generally taken not to be a share capital account if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies, is transferred to the account and the account is not already tainted.

40. The return of capital will be debited against RMS' share capital account. There have been no transfers into RMS' share capital account as defined in section 975-300 of the ITAA 1997.

41. Therefore, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies and the return of capital would not constitute a dividend.

Anti-avoidance provisions

42. Sections 45A and 45B 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 unfranked dividend that is paid by the company out of profits to the shareholder.

Streaming of dividends and capital benefits: section 45A

43. 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.

44. RMS will provide its shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b) and the capital benefit will be provided to all of the shareholders in the same proportion as their share holdings. As all shareholders benefit equally from the return of capital, there is no 'streaming' of capital benefits to some shareholders and not to others.

45. Accordingly, section 45A does not apply to the return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the return of capital to the shareholders of RMS.

Schemes to provide capital benefits in substitution for dividends: section 45B

46. Section 45B applies where certain payments are made to shareholders in substitution for dividends.

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

- 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 (the relevant 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 could 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 (paragraph 45B(2)(c)).

Each of these conditions is considered below.

Scheme

48. A 'scheme' for the purposes of section 45B is taken to have the same meaning as provided in subsection 177A(1) of Part IVA. That definition is widely drawn and includes any agreement, arrangement, understanding, promise, undertaking, scheme plan or proposal.

49. A return of share capital would constitute a scheme for the purposes of paragraph 45B(2)(a), because the return of capital will provide shareholders with a capital benefit.

Tax benefit

50. A taxpayer 'obtains a tax benefit' as defined in subsection 45B(9) if:

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

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.

51. 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 foreign resident shareholders: see paragraphs 74 to 77 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 under section 128B of the ITAA 1936. Therefore, RMS shareholders will obtain tax benefits from the return of capital.

Relevant circumstances

52. Under 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 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.

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

54. The relevant circumstances under subsection 45B(8) cover both the circumstances of the company and the shareholders. In this instance, as the return of capital was made to all RMS shareholders, regardless of their 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, are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

55. 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 company. In this case, RMS has decided to return to its shareholders contributed share capital that was realised upon exercise of share options issued in the past, when it was expected that further capital would be needed. The unexpected success of RMS' operations, resulting in the recent derivation of income, has obviated the need for this additional capital. However, as this is a recent change of affairs there are insufficient profits which could be paid in substitution of the capital return.

56. Management is of the opinion that the cash holdings which have already been generated, and those that will be generated, from the exercise of the share options are in excess of current and future capital requirements and management therefore proposes to distribute this surplus back to the shareholders. In other words, the capital distribution to be provided to shareholders is wholly attributable to, and will be paid from, excess share capital arising from the conversion of the share options. No part of the return is attributable to specific profits, realised or unrealised, of RMS.

57. 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. In the present case, the quantum of the return of capital is well in excess of the accumulated profits of RMS. It is clear that RMS does not have sufficient profits (realised and unrealised) to support the payment of a dividend of a similar amount in place of the return of capital.

58. As RMS has, up until the 2006 income year incurred accumulated losses, it is accepted that the distribution that will be paid under the return of capital is not in substitution for a dividend.

59. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (viii). 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 entered into or carried out, its form and substance and its financial and other implications for the persons involved. In this case the practical implications of the scheme for RMS and its shareholders are consistent with it being, in form and substance, a return of capital.

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

Application of section 45C

61. As the Commissioner will not make a determination under subsections 45A(2) or subsection 45B(3) in relation to the scheme 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 of the ITAA 1997.

CGT event G1: section 104-135

62. CGT event G1 (section 104-135 of the ITAA 1997) will happen when RMS pays the return of capital in respect of a share that a RMS shareholder owns at the time of the payment and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount that is taken to be a dividend under section 47 of the ITAA 1936.

63. If the return of capital amount is not more than the cost base of the RMS share at the time of the payment, the cost base and reduced cost base of that RMS share will be reduced (but not below nil) by the amount of the return of capital (subsection 104-135(4) of the ITAA 1997).

64. An RMS shareholder will make a capital gain if the return of capital amount is more than the cost base of their RMS share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

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

66. If the RMS share was acquired by the shareholder at least 12 months before the payment of the return of capital, a capital gain from CGT event G1 happening 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).

67. An RMS shareholder cannot make a capital loss when CGT event G1 happens.

CGT event C2: section 104-25

68. The right to receive the return of capital is one of the rights inherent in the RMS share at the Record Date. If, after the Record Date but before the payment date of the return of capital, a RMS shareholder ceases to own some, or all, of their shares in RMS, the right to receive the return of capital is retained by the shareholder and is considered to be a separate CGT asset.

69. CGT event C2 in section 104-25 of the ITAA 1997 will happen when the return of capital is paid and the right to receive that payment ends.

70. A RMS shareholder will make a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right (subsection 104-25(3) of the ITAA 1997). The capital proceeds will be the amount of the return of capital from RMS.

71. The cost base of the RMS shareholder's right to receive the return of capital is worked out in accordance with Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As the RMS shareholder will have paid nothing for the right, the cost base of the right is likely to be nil. Therefore, the RMS shareholder will generally make a capital gain equal to the amount of the return of capital.

72. As the right to receive the return of capital amount was inherent in the RMS share during the time that it was owned, the right is considered to have been acquired at the time when the share was acquired (section 109-5 of the ITAA 1997).

73. Consequently, if the RMS share to which the payment relates was originally acquired by the former RMS shareholder at least 12 months before the payment of the return of capital, 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).

Foreign resident shareholders

74. A foreign resident shareholder can disregard any capital gain made from the return of capital if their RMS shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997). The term 'taxable Australian property' includes an 'indirect Australian real property interest' (item 2 in the table in section 855-15 and section 855-25 of the ITAA 1997).

75. A RMS foreign resident shareholder will have an 'indirect Australian real property interest' if it holds a membership interest in RMS, and the interest passes the 'non-portfolio test' (section 960-195 of the ITAA 1997) and the 'principal asset test' (section 855-30 of the ITAA 1997).

76. As RMS' foreign resident shareholders, together with their associates, hold less than 10% of the shares in RMS, their interest will not pass the 'non-portfolio test'. Accordingly, RMS' foreign resident shareholders do not have an 'indirect Australian real property interest'.

77. Therefore, a RMS share will only be 'taxable Australian property' if the foreign resident shareholder has used their RMS share in carrying on a business through a permanent establishment in Australia (item 3 in the table in section 855-15 of the ITAA 1997).

Appendix 2 – Detailed contents list

78. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Subject references:

capital gains tax
capital streaming
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Legislative references:

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- ITAA 1936 128B
- ITAA 1936 Pt IVA
- ITAA 1936 177A(1)
- ITAA 1936 177D(b)(i)
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- ITAA 1936 177D(b)(iv)
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- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C

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