


CR 2007/94 - Income tax: payment of interim and special dividend by HPAL Limited

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Class Ruling

Income tax: payment of interim and special dividend by HPAL Limited

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	13
Ruling	23
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	28
Appendix 2:	
Detailed contents list	57

ⓘ 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 provisions 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:
- former section 160APHO of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 177EA of the ITAA 1936;
 - section 202-5 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
 - section 204-30 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares in HPAL Limited (HPAL), an Australian resident company listed on the Australian Stock Exchange (ASX), who receive the proposed fully franked interim dividend (interim dividend) and fully franked special dividend (special dividend) in conjunction with the disposal of their shares in HPAL to Salmat Limited (Salmat) pursuant to the Arrangement described in the Scheme part of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this 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 22 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 January 2007 to 31 December 2007. However, the Ruling continues to apply after 31 December 2007 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 scheme that is the subject of this Ruling is described below. This 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 dated 26 July 2007 from PricewaterhouseCoopers (PwC) on behalf of HPAL;
- copy of the Scheme Implementation Agreement received from PwC on 26 July 2007; and
- copy of the draft Scheme Booklet from PwC on 24 August 2007.

14. HPAL is an Australian incorporated company listed on the ASX. HPAL is the head company of the HPAL Limited Tax Consolidated Group.

15. On 18 July 2007, HPAL announced to the ASX that the Board of HPAL has recommended a proposal from Salmat in respect of a potential acquisition of the company.

16. The proposed transaction will be implemented by way of a Scheme of Arrangement under the *Corporations Act 2001*.

17. The total cash consideration that an existing HPAL shareholder could receive pursuant to the proposed transaction is \$2.725 per share less the amount of the interim dividend and special dividend.

18. As part of the proposed transaction HPAL will pay an interim dividend of 4.75 cents per share and a special dividend of 13.25 cents per share prior to the implementation of the Scheme of Arrangement.

19. The ex-dividend date for both the interim dividend and the special dividend is 13 August 2007.

20. The interim and special dividend will be paid on 28 September 2007. Both dividends are not conditional on the Scheme being approved by shareholders or implementation of the Scheme.

21. The Scheme Effective Date is 19 October 2007 and the Scheme Record Date is 26 October 2007.

22. The HPAL shares will be transferred to Salmat on the Implementation Date of the Scheme of Arrangement (1 November 2007).

Ruling

Franking of dividend

23. Where HPAL franks an interim dividend and a special dividend in accordance with section 202-5 of the ITAA 1997, both dividends will be a franked distribution.

Qualified persons

24. The ex-dividend date for the purposes of former section 160APHE for both the proposed interim dividend and special dividend is 14 August 2007.

25. The secondary qualification period runs from 30 June 2007 to 28 September 2007. Those HPAL shareholders who have held their HPAL shares 'at risk' for more than 45 days during the period 30 June 2007 to 28 September 2007 will be qualified persons with respect to the proposed fully franked interim dividend and special dividend.

The anti-avoidance provisions

26. The Commissioner will not make a determination under paragraph 177EA(5)(a) or 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit received in relation to the interim and special dividend received by HPAL shareholders.

27. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received in relation to the interim and special dividend received by HPAL shareholders.

Commissioner of Taxation17 October 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.*

Franking of dividend

28. The proposed dividends are to be a distribution made by HPAL to its shareholders and are to be debited against HPAL's retained earnings account. Therefore, the dividend constitutes a frankable distribution for the purposes of subsection 202-40(1) of the ITAA 1997, and is capable of being franked in accordance with section 202-5 of the ITAA 1997. Further, the distributions will not be rendered an unfrankable distribution pursuant to the operation of section 202-45 of the ITAA 1997.

Qualified persons

29. Former Division 1A¹ of the ITAA 1936 contains the measures known as the holding period rule and the related payment rule. In broad terms, former Division 1A of the ITAA 1936 provides the statutory tests that must be satisfied for a taxpayer to be a 'qualified person' with respect to a franked distribution they have received and thus be entitled to a tax offset for the franking credit attached to the distribution.

30. The test of what constitutes a 'qualified person' is provided in former section 160APHO of the ITAA 1936. Broadly speaking, to be a qualified person in relation to a dividend, a taxpayer must satisfy either the holding period rule or the related payment rule.

31. Former subsection 160APHO(1) of the ITAA 1936 states:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a 'qualified person' in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of a taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification in relation to the dividend.

¹ References to Division 1A of former Part IIIA of the ITAA 1936 and the provisions contained within that Division are references to the Division and those provisions as they existed on 30 June 2002.

32. If a taxpayer is not under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer will have to satisfy the holding period requirement within the primary qualification period. If a taxpayer is under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer will have to satisfy the holding period requirement within the secondary qualification period.

33. In order to determine which is the relevant qualification period, it is necessary to determine whether, under the present arrangement, the current shareholders of HPAL are considered to be under an obligation to make a related payment. Former section 160APHN of the ITAA 1936 provides non-definitive examples of what constitutes the making of a related payment for the purposes of former Division 1A of the ITAA 1936. Former subsection 160APHN(2) of the ITAA 1936 provides as follows:

The taxpayer or associate is taken, for the purposes of this Division, to have made, to be under an obligation to make, or to be likely to make, a related payment in respect of the dividend or distribution if, under an arrangement, the taxpayer or associate has done, is under an obligation to do, or may reasonably be expected to do, as the case may be, anything having the effect of passing the benefit of the dividend or distribution to one or more other persons.

34. Former subsection 160APHN(3) of the ITAA 1936 states:

Without limiting subsection (2), the doing of any of the following by the taxpayer or an associate of the taxpayer in the circumstances mentioned in subsection (4) may have the effect of passing the benefit of the dividend or distribution to one or more other persons:

- (a) causing a payment or payments to be made to, or in accordance with the directions of, the other person or other persons; or
- (b) causing an amount or amounts to be credited to, or applied for the benefit of, the other person or the other persons; or
- (c) causing services to be provided to, or in accordance with the directions of, the other person or other persons; or
- (d) causing property to be transferred to, or in accordance with directions of, the other person or other persons; or
- (e) allowing any property or money to be used by the other person or other persons or by someone nominated by the other person or other persons; or
- (f) causing an amount or amounts to be set off against, or to be otherwise applied in reduction of, a debt or debts owed by the other person or other persons; or
- (g) agreeing to treat an amount or amounts owed to the other person or other persons by the taxpayer or associate as having been increased.

35. Former subsection 160APHN(4) of the ITAA 1936 states:

The circumstances referred to in subsection (3), are where:

- (a) the amount or the sum of the amounts paid, credited or applied; or
- (b) the value or the sum of the values of the services provided, of the property transferred or of the use of the property or money; or
- (c) the amount or the sum of the amounts of the set-offs, reductions or increases;

as the case may be:

- (d) is, or may reasonably be expected to be, equal to; or
- (e) approximates or may reasonably be expected to approximate; or
- (f) is calculated by reference to; the amount of dividend or distribution.

36. In the current circumstances, an integral part of the arrangement is the planned payment of the interim dividend of 4.75 cents and the special dividend of 13.25 cents per share. Further, it is clearly contemplated in the current arrangement that the total cash consideration to be paid by Salmat is to be reduced by the aggregate amount of the interim dividend and the special dividend to be paid. The reduction is specifically calculated by reference to the amount of the interim dividend and special dividend paid. In essence, Salmat would pay \$2.545 per share instead of \$2.725 per share when the interim and special dividend is paid. Likewise, HPAL shareholders would receive \$2.545 from Salmat from the disposal of their shares when the interim and special dividend is paid as against the total consideration of \$2.725 to be provided pursuant to the Scheme of Arrangement.

37. As the Scheme of Arrangement clearly contemplates the reduction in the consideration for the disposal of a HPAL share to be calculated by reference to the value of the interim and special dividend paid pursuant to the Scheme of Arrangement, the reduction in the consideration is considered to constitute a notional credit passing on the benefit of the proposed interim and special dividend from an HPAL shareholder to Salmat. As such, it is considered to constitute a related payment for the purposes of former section 160APHN of the ITAA 1936.

38. As the HPAL shareholders are taken, for the purposes of former Division 1A of the ITAA 1936, to be under an obligation to make a related payment in respect of the interim and special dividend, the relevant holding period is therefore the secondary qualification period pursuant to former paragraph 160APHO(1)(b) of the ITAA 1936.

39. The secondary qualification period is defined in former section 160APHD of the ITAA 1936 as follows:

in relation to a taxpayer in relation to shares or an interest in shares, means:

- (a) if the shares are not preference shares – the period beginning on the 45th day before, and ending on the 45th day after, the day on which the shares or interest becomes *ex dividend*...

40. The concept of 'ex dividend' is defined by former subsection 160APHE(1) of the ITAA 1936 as follows:

A share in respect of which a dividend is to be paid, or an interest (other than an interest as a beneficiary of a widely held trust) in such a share, becomes *ex dividend* on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

41. Pursuant to the Scheme of Arrangement, HPAL has advised that the last day that an HPAL share can be acquired with an entitlement to the interim and special dividends is 13 August 2007. Accordingly, the ex-dividend date for the purposes of former subsection 160APHE(1) is 14 August 2007.

42. The secondary qualification period therefore begins 45 days before the ex dividend date of 14 August 2007 and ends 45 days after that day. In practical terms, this means that the secondary qualification period begins on 30 June 2007 and ends on 28 September 2007. However, pursuant to former subsection 160APHO(3), any days on which a taxpayer has materially diminished risks of loss or opportunities for gain in respect of the HPAL shares are to be excluded. Having regard to the Scheme of Arrangement, it does not have any features which would lead to the conclusion that shareholders would have materially diminished risks of loss or opportunities for gain during the secondary qualification period.

43. Accordingly, the secondary qualification period would begin on 30 June 2007 and end on 28 September 2007. HPAL shareholders who receive the proposed interim and special dividend would need to hold their shares at risk for 45 days during this period in order to be a 'qualified person' for the purposes of former Division 1A of the ITAA1936. Further, pursuant to former paragraph 160APHO(2)(a) of the ITAA 1936, the date of acquisition or disposal are not included in the relevant 45 day period. This would have the effect in the present circumstances, for example, that the 45 day qualification period could not include 30 June 2007 if this was the date of acquisition of HPAL shares or 28 September 2007 if this was the date of disposal of HPAL shares.

The anti-avoidance provisions**Section 177EA**

44. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes to obtain a tax advantage in relation to imputation benefits. In essence, it applies to schemes for the disposition of shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares.

45. Specifically, subsection 177EA(3) of the ITAA 1936 provides that section 177EA applies if:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the person (the 'relevant taxpayer') would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) 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 an imputation benefit.

46. If section 177EA of the ITAA 1936 applies, the Commissioner may make a determination under subsection 177EA(5) that either a franking debit arises to the company in respect of each dividend paid to the relevant taxpayer or, in the alternative, that no franking credit benefit arises in respect of a dividend paid to the relevant taxpayer.

47. HPAL is a corporate tax entity. The sale of the ordinary shares in HPAL pursuant to a Scheme of Arrangement is a scheme for the disposition of membership interest.

48. In the present case, it is considered that the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme (as provided for in subsection 177EA(17) of the ITAA 1936), it would be concluded that, on the part of HPAL, its shareholders or any other relevant party, there is a purpose of more than merely an incidental purpose of conferring a franking credit benefit under the scheme.

49. In arriving at a conclusion one must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of diverse matters which taken individually or in conjunction with other matters, listed or not, could indicate the requisite purpose, that is, that the delivery of the franking credit benefit is more than an incidental purpose of the scheme.

50. The relevant circumstances are that the disposition of the ordinary shares in HPAL is made pursuant to a takeover offer made by Salmat. The takeover of HPAL by way of a Scheme of Arrangement is one of the alternatives available under the *Corporations Act 2001* to be voted upon by HPAL's existing shareholders. This particular Scheme of Arrangement is an ordinary commercial transaction. There is no intention evidenced in the scheme that the payment of the proposed interim and special dividend is to enable a particular shareholder or class of shareholders (current and future) to obtain imputation benefits. This is further supported by the fact that even if the scheme does not take place, the interim dividend and special dividend will still be paid and as such all HPAL shareholders will still receive imputation benefits.

51. Having regard to the relevant circumstances of the scheme, it cannot be concluded that HPAL or the shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain a franking credit benefit.

Section 204-30

52. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an imputation benefit is, or apart from this section would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); and

- (c) the other member of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c) of the ITAA 1997).

53. If section 204-30 of the ITAA 1997 applies the Commissioner has discretion under subsection 204-30(3) to make a determination in writing:

- (a) that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a) of the ITAA 1997); and/or
- (b) that no imputation benefit is to arise in respect of any streamed distributions made to a favoured member and specified in the determination (paragraph 204-30(3)(c) of the ITAA 1997).

54. For section 204-30 of the ITAA 1997 to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than other members. The words 'derives a greater benefit from franking credits' (imputation benefits) are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

55. Under the current proposal for the payment of interim dividend and special dividend, all HPAL shareholders will receive an imputation benefit as a result of the interim and special dividend. Australian resident shareholders will receive the benefit of a tax offset (paragraph 204-30(6)(a) of the ITAA 1997) or receive a franking credit to their franking account as a result of the distribution and the non-resident shareholders will receive an imputation benefit in the form of an exemption from dividend withholding tax (paragraph 204-30(6)(e) of the ITAA 1997). The resident shareholders will derive a greater benefit from franking credits than the non-resident shareholders. However, as the proposed distributions are to be fully franked and paid to all the shareholders, it cannot be argued that HPAL has directed the flow of distributions in such a manner so as to ensure that imputation benefits are derived by shareholders who derive greater benefit from franking credits, while other shareholders receive lesser or no imputation benefits.

56. Having regard to all of the relevant circumstances it is considered that section 204-30 of the ITAA 1997 does not apply.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	8
Scheme	13
Ruling	23
Franking of dividend	23
Qualified persons	24
The anti-avoidance provisions	26
Appendix 1 – Explanation	28
Franking of dividend	28
Qualified persons	29
The anti-avoidance provisions	44
<i>Section 177EA</i>	44
<i>Section 204-30</i>	52
Appendix 2 – Detailed contents list	57

References

Previous draft:

Not previously issued as a draft

Subject references:

- deemed dividends
- dividend income
- dividend streaming arrangements
- frankable dividends
- imputation system
- franking credits

- ITAA 1936 177EA(3)
- ITAA 1936 177EA(3)(a)
- ITAA 1936 177EA(3)(b)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(5)
- ITAA 1936 177EA(5)(a)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(17)
- ITAA 1997 202-5
- ITAA 1997 202-40(1)
- ITAA 1997 202(45)
- ITAA 1997 204-30
- ITAA 1997 204-30(1)(a)
- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)
- ITAA 1997 204-30(3)(a)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 204-30(6)(a)
- ITAA 1997 204-30(6)(e)
- ITAA 1997 204-30(8)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001

Legislative references:

- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 160APHD
- ITAA 1936 APHE
- ITAA 1936 APHE(1)
- ITAA 1936 APHN
- ITAA 1936 APHN(2)
- ITAA 1936 APHN(3)
- ITAA 1936 APHN(4)
- ITAA 1936 APHO
- ITAA 1936 APHO(1)
- ITAA 1936 APHO(1)(b)
- ITAA 1936 APHO(2)(a)
- ITAA 1936 APHO(3)
- ITAA 1936 177EA

ATO references

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