

# ***CR 2008/52 - Income tax: return of capital: in specie distribution of shares by Legend Mining Limited***

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## Class Ruling

### Income tax: return of capital: in specie distribution of shares by Legend Mining Limited

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#### **① 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 45B of the ITAA 1936;
  - section 45C of the ITAA 1936;
  - section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
  - section 104-135 of the ITAA 1997.

All legislative references are to the ITAA 1936 unless otherwise indicated.

## Class of entities

3. The class of entities to which this Ruling applies are the shareholders of Legend Mining Ltd (Legend) who:
- (a) own ordinary shares in Legend and are registered on the Legend share register on the Record Date, being the date for determining entitlements to the *in specie* Return of Capital described in paragraphs 14 to 24 of this Ruling;
  - (b) hold those shares on capital account; and
  - (c) are residents of Australia (as that term is defined in subsection 6(1)) at the time the scheme is undertaken.
4. In this Ruling this class of entities is referred to as the 'participating Legend shareholders.'

## Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.
6. 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 14 to 24 of this Ruling.
7. 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

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9. This Ruling applies from 1 July 2006 to 30 June 2008. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

10. 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.

11. 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)).

12. 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.

13. 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

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14. This description is based on a number of documents provided to the Commissioner. 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 the arrangement include:

- Class Ruling Application dated 29 June 2007 from MKT-Taxation Advisors;
- Correspondence from MKT-Taxation Advisors providing further information on various dates between 29 June 2007 and 13 September 2007;
- Correspondence from MKT-Taxation Advisors dated 4 March 2008

**Note:** where certain information received from MKT-Taxation Advisors was provided on a commercial-in-confidence basis, it will not be disclosed or released under the Freedom of Information legislation.

## Background

15. On 1 May 2007, Legend and Gidgee Resources Ltd (Gidgee), which is a wholly owned subsidiary of Legend, entered into a conditional sale agreement with Apex Minerals NL (Apex) under which certain mineral properties and plant assets (referred to as the Gidgee Gold Project assets) were sold to Apex. In return, Legend received 34 million ordinary Apex shares (which, at that time, equalled the market value of the Gidgee property and plant) and contingent consideration of \$5 million upon certain gold production milestones being achieved. Legend is entitled to receive and intends to use for its own purposes any of the contingent consideration actually paid by Apex.

16. Legend is an Australian Securities Exchange (ASX) listed public company, incorporated in September 1993, whose principal activities involve exploring for gold and base metal deposits.

## Distribution of Apex shares to the Legend shareholders

17. In its announcement to the ASX on 3 May 2007, Legend stated that it would distribute the 34 million Apex shares to its shareholders upon completing the sale, subject to the necessary approvals being received. Legend held a general meeting with shareholders to confirm these arrangements at the end of October 2007. All of Legend's subsequent announcements were in terms of the 34 million shares being distributed to its shareholders.

18. Legend has only used equity capital to fund its investment in the Gidgee Gold Project, its equity investment totalling \$30,334,386. For the income years to 2007, Legend has never had profits available for distribution to its shareholders.

19. The *in specie* distribution was treated for corporate and accounting purposes as a return of capital up to the amount of Legend's equity investment in the Gidgee Gold Project. Any amounts distributed to shareholders by way of the *in specie* distribution of Apex shares in excess of Legend's equity investment in the Gidgee Gold Project was treated as a dividend by Legend.

## Reason for the sale of assets and distribution

20. Legend expects that the *in specie* distribution will not have any adverse commercial impact on its business operations. Gidgee has not commenced any production, nor made any profits since its incorporation in April 2003.

21. All entitlements of Legend shareholders to receive Apex shares as a distribution *in specie* will accrue to those shareholders included on Legend's Register of Members on the Record Date, 2 November 2007.

22. Legend has no knowledge of any capital losses that are available to its shareholders.

**Other matters**

23. Legend confirms that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997, from any of its other accounts. All Legend shareholders acquired their Legend shares on or after 20 September 1985.

24. The value of the 34 million Apex shares that Legend received on the sale of the Gidgee Gold Project fluctuated between the date of the sale and the date that they were distributed *in specie* to Legend shareholders. As of the date of the *in specie* distribution of the Apex shares, Legend debited \$30,334,386 to its share capital account, and \$12,845,614 to its current year profits. This equates to 2.635 cents per share debited to the share capital account and 1.115 cents per share treated as a dividend.

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**Ruling**

25. The amount of the *in specie* Return of Capital in the form of Apex shares to the Legend Shareholders under the scheme was not a 'dividend' as defined by subsection 6(1).

**Anti-avoidance provision – section 45B**

26. The Commissioner will not make a determination under section 45B that section 45C applies to the *in specie* Return of Capital received by participating Legend shareholders. Accordingly no part of the *in specie* Return of Capital will be taken to be a dividend pursuant to subsection 45C(1).

**Capital gains tax (CGT) consequences**

27. CGT event G1 happened to the participating Legend shareholders when Legend paid the *in specie* Return of Capital (section 104-135 of the ITAA 1997).

28. CGT event C2 happened when Legend paid the *in specie* Return of Capital to a participating Legend shareholder who was registered as a Legend ordinary shareholder on the Record Date but ceased to own their Legend share at the time when the *in specie* Return of Capital was paid (section 104-25 of the ITAA 1997).

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**Commissioner of Taxation**6 August 2008

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## 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.*

### Dividends

29. The definition of 'dividend' in subsection 6(1) has the effect that any distribution made by the company to any of its shareholders, whether in money or property, is a dividend except where the distribution is debited against an amount standing to the credit of the share capital account of the company (paragraphs (a) and (d) of the definition).

30. It has been submitted that the *in specie* Return of Capital has been debited against Legend's share capital account. Therefore, the Return of Capital in the form of the *in specie* distribution of shares in Apex will not be a dividend for the purposes of subsection 6(1) to the extent of such debiting.

### Anti-avoidance provision – section 45B

31. Section 45B is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C applies. The effect of such a determination is that all or part of the shares in Apex received by the Legend shareholders under the *in specie* Return of Capital are treated as an unfranked dividend. Accordingly, the application of these two provisions to the *in specie* Return of Capital must be considered.

32. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. In broad terms, section 45B applies where:

- 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, 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 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

33. The *in specie* Return of Capital by Legend is a scheme within the broad meaning of that term.

***Provided with a capital benefit***

34. The meaning of 'provided with a capital benefit' is given in subsection 45B(5) which states:

A reference to a person being provided with a capital benefit is a reference to any of the following:

- (a) the provision of ownership interests in a company to the person;
- (b) the distribution to the person of share capital or share premium;
- (c) something that is done in relation to an ownership interest that has the effect of increasing the value of an ownership interest (which may or may not be the same interest) that is held by the person.

35. Pursuant to the scheme, Legend shareholders were provided with shares in Apex. Legend debited its share capital account in relation to the distribution of the Apex shares. This satisfied the definition of 'provided with a capital benefit' for the purpose of section 45B under paragraph 45B(5)(b).

***Tax benefit***

36. In addition to being provided with a capital benefit, paragraph 45B(2)(b) also requires that the shareholder obtains a 'tax benefit', which is defined in subsection 45B(9), 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.

37. Ordinarily, a return of capital would be subject to the CGT provisions under the income tax law. Unless the amount of the distribution exceeds the cost base of the share there will only be a cost base reduction under CGT Event G1 (that is section 104-135 of the ITAA 1997). It is only to the extent (if any) that the distribution exceeds the cost base of the share that a capital gain is made. A capital gain may not arise at all for certain foreign shareholders. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or, in the case of a non-resident, would potentially be subject to dividend withholding tax. Therefore, Legend shareholders will obtain tax benefits from the *in specie* Return of Capital.

***Relevant circumstances***

38. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the 'relevant circumstances' set out in 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.

39. The test of purpose is an objective one. The question is whether 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.

40. The relevant circumstances under subsection 45B(8) cover the circumstances of Legend and the tax profiles of the Legend shareholders. In the present situation, it is considered that the matters covered by paragraphs 45B(8)(a), (b), (h) and (k) are the most relevant.

41. The relevant circumstance of a scheme under paragraph 45B(8)(a) includes the extent to which the capital benefit is attributable to capital or the extent to which the capital benefit is attributable to profits (realised or unrealised) of Legend or its associates. Legend has confirmed that it does not have any prior year profits and that the investment in Gidgee was entirely sourced out of equity capital. With respect to the arrangement from Legend's perspective, Legend considered that it was appropriate to treat the *in specie* distribution of Apex shares as an *in specie* Return of Capital up to the amount of Legend's equity investment in the Gidgee Gold Project, with the balance being distributed as a dividend. Legend has acknowledged that the predominant reason for the *in specie* Return of Capital was to allow Legend shareholders to retain an interest in the Gidgee Project.

42. Paragraph 45B(8)(b) covers the relevant circumstance that includes the pattern of distributions of dividends and returns of capital by the company. Legend has never generated an accounting profit in the previous financial years and therefore has not been in a position under the *Corporations Act 2001* to declare and distribute a dividend to Legend shareholders. Whilst carrying on its business, Gidgee also did not derive a profit. Further, it has also been confirmed that Legend has never undertaken a capital return in the past.

43. Paragraph 45B(8)(h) considers whether the shareholder's equity interest in the company is the same before and after the distribution of share capital. In this case, following the equal capital reduction satisfied by the *in specie* distribution of Apex shares, the proportionate and voting interests of each shareholder in the company will remain unchanged. The effect is that the distribution of share capital by way of *in specie* distribution is not economically dissimilar to an ordinary or special dividend where cash is received by a shareholder.

44. 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 carried out, its form and substance, and its financial and other implications for the parties involved.

45. In this case, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, the requisite purpose of enabling the eligible shareholders to obtain a tax benefit (by way of *in specie* Return of Capital) was not present.

46. Having regard to the relevant circumstances of the scheme, set out in subsection 45B(8), it cannot be concluded that any of the parties to the scheme entered into or carried out the scheme for more than an incidental purpose of obtaining a tax benefit in the form of a capital benefit. The *in specie* Return of Capital cannot be said to be attributable to the profits of Legend, nor do the pattern of distributions indicate that it is being paid in substitution for a dividend. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the *in specie* Return of Capital.

### **Capital gains tax consequences**

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

47. CGT event G1 (section 104-135 of the ITAA 1997) happens 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 (non-assessable part) is not a dividend, or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

48. The payment can include giving property (section 103-5 of the ITAA 1997). Accordingly the amount of the payment for the purposes of CGT event G1 was the market value of the Apex shares at the time when the Apex shares were distributed (that is, when the payment was made).

49. CGT event G1 happened to the participating Legend shareholders who held Legend shares at the time of the *in specie* Return of Capital. Under section 109-5 of the ITAA 1997, the participating Legend shareholders acquired their Apex shares at the time when the *in specie* distribution by Legend happened.

50. As a result of CGT event G1 happening, the cost base and reduced cost base of each Legend share is reduced (but not below nil) by the non-assessable part, in this case being the amount of the *in specie* Return of Capital (subsections 104-135(3) and (4) of the ITAA 1997).

51. A participating Legend shareholder made a capital gain if the *in specie* Return of Capital by the company in relation to each Legend share exceeds the cost base of the share (subsection 104-135(3) of the ITAA 1997). If the Legend share was acquired by the shareholder at least 12 months before the date of payment, a capital gain from the share 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.

**CGT event C2: section 104-25**

52. If, after the Record Date but before the time of the *in specie* Return of Capital, a participating Legend shareholder ceased to own some, or all, of their ordinary shares in Legend in respect of which the *in specie* Return of Capital was payable, the right to receive the payment in respect of each of the shares disposed of is considered to be a separate CGT asset. That right was one of the rights inherent in the share at the Record Date and was retained by the shareholder when the share was sold.

53. CGT event C2, in section 104-25 of the ITAA 1997, happened when the *in specie* Return of Capital was paid and the participating Legend shareholder's right to receive that payment ended.

54. The participating Legend shareholder makes a capital gain if the capital proceeds from the ending of the right were more than the cost of the right (subsection 104-25(3) of the ITAA 1997). The capital proceeds are the market value of the Apex shares received under the *in specie* distribution pursuant to subsection 116-20(1) of the ITAA 1997.

55. The cost base of the participating Legend shareholder's right to receive the *in specie* Return of Capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As no amount will have been paid for the right by the participating Legend shareholder, the cost base of the right is likely to be nil. Therefore, for a participating Legend shareholder, a capital gain equal to the amount received as the *in specie* Return of Capital is likely to arise.

56. As the right to receive the *in specie* Return of Capital from Legend was inherent in the Legend ordinary share during the time that it was owned, the right is considered to have been acquired at the time when the Legend ordinary share was acquired (section 109-5 of the ITAA 1997). Consequently, if the Legend share was originally acquired by the former Legend shareholder at least 12 months before the payment, a capital gain from CGT event C2 happening to 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.

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Subject references:*

- capital gains
- capital gains tax
- CGT assets
- CGT cost base
- return of capital on shares
- shareholders

*Legislative references:*

- ITAA 1936 47
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
- ITAA 1936 177D(b)(iii)
- ITAA 1936 177D(b)(iv)
- ITAA 1936 177D(b)(v)
- ITAA 1936 177D(b)(vi)
- ITAA 1936 177D(b)(vii)
- ITAA 1936 177D(b)(viii)
- ITAA 1997
- ITAA 1997 103-5
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 975-300
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(5)
- ITAA 1936 45B(5)(b)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 45C(1)

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ATO references

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