


CR 2009/30 - Income tax: Allco Equity Partners Limited: proposed return of capital

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Class Ruling

Income tax: Allco Equity Partners Limited: proposed return of capital

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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
- Division 855 of the ITAA 1997.

All subsequent 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 are the shareholders of Allco Equity Partners Limited (AEP) who:
- (a) are registered on the AEP share register on the Record Date, being the date for determining entitlements under the proposed return of capital as described in paragraphs 9 to 21 of this Ruling; and
 - (b) who hold their initial ordinary shares and ordinary shares (as applicable) on capital account.

In this Ruling, those entities are referred to as 'AEP shareholders' and the initial ordinary share and the ordinary share are referred to as an 'AEP share'.

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 9 to 21 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 10 June 2009 to 30 June 2010. The Ruling continues to apply after 30 June 2010 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will 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 this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme that is the subject of this Ruling is based on the following documents provided by Mallesons Stephen Jaques (the Applicant). These documents, or relevant parts of them, form part of and are to be read in conjunction with this description:

- the application for Class Ruling dated 22 April 2009 lodged by the Applicant on behalf of AEP; and
- various correspondence from the Applicant providing further information from 1 May 2009 to 29 May 2009.

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

10. AEP is an Australian investment company which was incorporated on 12 November 2004. AEP was listed on the Australian Securities Exchange on 22 December 2004 following the completion of an initial public share offer (IPO).

11. AEP raised \$550,000,088 in share capital under the IPO and from the issue of initial ordinary AEP shares. The capital raised had been intended to be deployed by AEP in making investments.

12. Between June 2007 and November 2008 AEP undertook two on-market share buy-backs as part of its capital management strategy. The capital management strategy at that time involved the return of capital which had not been deployed by AEP in making investments. The on-market share buy-backs resulted in AEP acquiring 9,930,556 shares for total cost of \$29,916,938 (net of brokerage and transaction costs).

13. The share capital of AEP as at 31 March 2009, net of adjustments, was \$485,964,506.

Proposed return of capital

14. On 3 April 2009, AEP announced that it proposed to make a return of capital of approximately \$60 million to shareholders, which equates to \$0.65 per AEP share. The proposed return of capital forms part of a four part program aimed at maximising AEP shareholder value. The program includes the suspension of new investments and the maintenance of existing investments and their profitable realisation.

15. The proposed return of capital will be sourced from AEP's existing cash funds, which were approximately \$95 million as at 31 March 2009. The cash funds are referable to the capital raised by AEP from the issue of AEP shares under the IPO.

16. The proposed return of capital is subject to AEP shareholders' approval and will be considered at a meeting to be held on 24 June 2009. The proposed return of capital will be applied equally to each holder of an AEP share on the register on the Record Date, being 3 July 2009, by way of cash distribution in proportion to the number of shares held on that date. Payment of the proposed return of capital is expected to be made within approximately 10 business days of the approval by AEP shareholders, currently anticipated to be 9 July 2009 (the Payment Date).

17. AEP will debit the entire amount of the proposed return of capital against the share capital of AEP. There will be no change in either the number of AEP shares held by each AEP shareholder or the proportionate interest of each AEP shareholder in AEP as a result of the proposed return of capital.

18. There will have been no transfers to AEP's share capital account, as defined in section 975-300 of the ITAA 1997, prior to the proposed return of capital which would cause the share capital account to become tainted in terms of section 197-50 of the ITAA 1997.

Other aspects

19. AEP has paid dividends to AEP shareholders in respect of the income years ended 30 June 2006, 2007 and 2008.

20. The proposed return of capital will be made in addition to the payment of interim dividends and any final dividends by AEP in respect of the year ended 30 June 2009. The proposed return of capital will not affect AEP's current dividend policy under which the company intends to distribute all realised after tax profits.

21. The Applicant has advised that AEP's indirect interests in Australian real property does not pass the non-portfolio interest test and/or the principal asset test (refer to sections 855-25, 855-30 and 960-195 of the ITAA 1997).

Ruling

Distribution is not a dividend

22. The proposed return of capital to AEP shareholders will not be a dividend, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C to the proposed return of capital

23. The Commissioner will not make a determination under sections 45A or 45B that section 45C applies to the proposed return of capital. Accordingly, no part of the proposed return of capital will be taken to be a dividend for income tax purposes.

Capital gains tax

24. CGT event G1 (section 104-135 of the ITAA 1997) will happen when AEP pays the proposed return of capital to an AEP shareholder in respect of an AEP share that they own at the Record Date and continue to own at the Payment Date.

25. CGT event C2 (section 104-25 of the ITAA 1997) will happen when AEP pays the proposed return of capital to an AEP shareholder in respect of an AEP share that they own at the Record Date but cease to own before the Payment Date.

Foreign resident shareholders

26. A foreign resident AEP shareholder who is paid the proposed return of capital disregards any capital gain made when CGT event G1 happens if their AEP share is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

27. A foreign resident AEP shareholder who is paid the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens if their right to receive the proposed return of capital is not 'taxable Australian Property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

10 June 2009

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

28. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholders 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).

29. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, this broad definition is subject to specific exclusions.

30. Paragraph (d) of the definition 'dividend' in subsection 6(1) specifically excludes from the definition:

...moneys paid or credited by a company to a shareholder ... (not being moneys ... to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited ... for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited ... is debited against an amount standing to the credit of the share capital account of the company;

31. The proposed return of capital will be wholly debited against the share capital account of AEP. There have been no transfers to AEP's share capital account, as defined in section 975-300 of the ITAA 1997, prior to the proposed return of capital which would:

- cause the share capital account to become tainted in terms of section 197-50 of the ITAA 1997; or
- prevent AEP's share capital account from being treated as a share capital account for the purposes of paragraph (d) of the definition of 'dividend' in subsection 6(1).

32. Therefore, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies and the proposed return of capital will not be a dividend.

Subsection 6(4)

33. The exclusion in paragraph (d) of the definition of dividend in subsection 6(1) is limited by subsection 6(4) which applies in circumstances where, under an arrangement:

- (a) a company raises share capital, receiving either cash or property from a person or group of persons crediting it to its share capital account; and

- (b) returns it to another person or group of persons, giving them either cash or property, debiting it to its share capital account.

34. In the present case, no arrangements exist under which AEP raised capital from certain shareholders and then distributes the capital raised to other shareholders. Accordingly, subsection 6(4) will have no application in respect of the proposed return of capital.

The application of sections 45A, 45B and 45C to the proposed return of capital

Section 45A – streaming of dividends and capital benefits

35. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

36. Although AEP will be providing its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), the capital benefit is to be provided to all AEP shareholders in direct proportion to their individual shareholding. The circumstances of the scheme do not indicate that there is a 'streaming' of capital benefits to advantaged shareholders and of dividends to disadvantaged shareholders. Accordingly, section 45A will not apply to the proposed return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the capital benefit.

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

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

38. Subsection 45B(2) sets out the conditions under which the Commissioner may 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 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 (paragraph 45B(2)(c)).

Each of the conditions is considered below.

39. The proposed return of capital will be a 'scheme' for the purposes of section 45B.

40. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). Relevantly, it includes a distribution to a person of share capital. As AEP proposes to debit the proposed return of capital against its untainted share capital account, AEP shareholders, under the scheme, will be provided with a capital benefit.

41. A shareholder '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.

42. 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 foreign resident shareholders: see paragraphs 65 and 68 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 non-resident be subject to dividend withholding tax. Therefore, an AEP shareholder will generally obtain a tax benefit from the proposed return of capital.

Relevant circumstances

43. 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 was entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

44. 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 or any part of 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.

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

46. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised or unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, the proposed return of capital is sourced from cash funds existing as at 31 March 2009 of approximately \$95 million. The existing cash funds, of which approximately \$60 million is to be used to fund the proposed return of capital, are referable to the capital raised by the issue of AEP shares under the IPO. In these circumstances, the proposed return of capital is attributable to capital and not to any realised or unrealised profits of AEP.

47. 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. Since the IPO, AEP has adopted a dividend policy of distributing all realised after tax profits. The proposed return of capital will be made in addition to the payment of interim and any final dividends by AEP in respect of the year ended 30 June 2009. The proposed return of capital will not affect the current dividend policy of AEP. The capital returns AEP undertook between June 2007 and November 2008, by way of on-market share buy-backs, arose under similar circumstances as this proposed return of capital. Accordingly, AEP's pattern of distributions does not suggest that the proposed return of capital will be made in substitution for dividends.

48. 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. In this case, the practical implications of the scheme for AEP and its shareholders are consistent with it being, in form and substance, a distribution of share capital.

49. Therefore, having regard to the relevant circumstances of the scheme involving the proposed return of the capital, as discussed in paragraphs 45 to 47 of this Ruling, it cannot be concluded that AEP will enter into, or carry out, the scheme for a purpose other than a merely incidental purpose of enabling the AEP shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3), that section 45C applies to the whole, or a part, of the capital benefit represented by the proposed return of capital.

Section 45C

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

Capital gains tax

CGT event G1 – section 104-135

51. CGT event G1 will happen when AEP pays the proposed return of capital amount to an AEP shareholder in respect of a share that a shareholder owns at the Record Date and continues to own at the Payment Date (section 104-135 of the ITAA 1997).

52. If the proposed return of capital (\$0.65 per AEP share) is less than, or equal to, the cost base of the AEP share at the Payment Date, the cost base and reduced cost base of the share will be reduced (but not below nil) by the amount of the proposed return of capital (subsection 104-135(4) of the ITAA 1997).

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

54. If an AEP shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the AEP share is reduced to nil (subsection 104-135(3) of the ITAA 1997). An AEP shareholder cannot make a capital loss when CGT event G1 happens.

55. A capital gain made when CGT event G1 happens will be a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the AEP share was acquired at least 12 months before the payment of the proposed return of capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Subdivision are satisfied.

CGT event C2 – section 104-25

56. The right to receive the proposed return of capital is one of the rights inherent in an AEP share at the Record Date. If, after the Record Date but before the Payment Date, an AEP shareholder ceases to own their AEP shares in respect of which the proposed return of capital is payable, the right to receive the payment will be retained by the shareholder and is a separate CGT asset.

57. CGT event C2 will happen when the proposed return of capital is paid. The right to receive the payment (being an intangible CGT asset) will end when the payment is made (section 104-25 of the ITAA 1997).

58. An AEP 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. The capital gain is equal to the amount of the excess. An AEP shareholder will make a capital loss if the capital proceeds from the ending of the right are less than the reduced cost base of the right (subsection 104-25(3) of the ITAA 1997). The capital loss is equal to the amount of the difference.

59. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the proposed return of capital (subsection 116-20(1) of the ITAA 1997).

60. The cost base of the AEP shareholder's right to receive the proposed return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997).

61. The cost base of the right does not include the cost base (or reduced cost base) of the share previously owned by an AEP shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share - for example, when the AEP shareholder disposes of the share after the Record Date but before the Payment Date.

62. Therefore, if the full cost base (or reduced cost base) of the AEP share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share then the right to receive the proposed return of capital will have a nil cost base.

63. As the right to receive the payment of the proposed return of capital was inherent in an AEP share during the time it was owned, the right is considered to have been acquired at the time when the corresponding AEP share was acquired (section 109-5 of the ITAA 1997).

64. Consequently, if the AEP share to which the payment relates was originally acquired by the former AEP shareholder at least 12 months before the payment of the proposed return of capital, a capital gain made when CGT event C2 happens 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

65. A foreign resident AEP shareholder who receives payment of the proposed return of capital, and makes a capital gain when CGT event G1 happens to their AEP shares, disregards the capital gain if the AEP shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

66. On the basis of what has been advised by the Applicant, an AEP share is not an 'indirect Australian real property interest' (as defined in section 855-25 of the ITAA 1997) for any foreign resident AEP shareholder who is entitled to the proposed return of capital.

67. Consequently, an AEP share is only 'taxable Australian property' for foreign resident individuals who:

- stopped being Australian residents while holding their AEP share; and
- chose, under subsection 104-165(2) of the ITAA 1997, to disregard a capital gain or capital loss from CGT event I1 (section 104-160 of the ITAA 1997) in relation to their AEP share (subsection 104-165(3) of the ITAA 1997, subsections 104-165(1) and 104-165(2) of the *Income Tax (Transitional Provisions) Act 1997*).

68. A foreign resident AEP shareholder who has a right to the payment of the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens to that right because the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- banking, finance & securities
- capitalisation
- finance
- return of capital on shares
- share capital

Legislative references:

- ITAA 1936 45B(8)(j)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
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- ITAA 1997
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-135
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- ITAA 1997 104-160
- ITAA 1997 104-165(2)
- ITAA 1997 104-165(3)
- 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 197-50
- ITAA 1997 Div 855
- ITAA 1997 855-10
- ITAA 1997 855-25
- ITAA 1997 855-30
- ITAA 1997 960-195
- ITAA 1997 975-300
- IT(TP)A 1997
- IT(TP)A 1997 104-165(1)
- IT(TP)A 1997 104-165(2)
- TAA 1953
- Copyright Act 1968

ATO references

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