


# ***CR 2010/18 - Income tax: proposed return of capital: Energy Infrastructure Trust***

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## Class Ruling

### Income tax: proposed return of capital: Energy Infrastructure Trust

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Contents	Para
<b>LEGALLY BINDING SECTION:</b>	
<b>What this Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>8</b>
<b>Scheme</b>	<b>9</b>
<b>Ruling</b>	<b>27</b>
<b>NOT LEGALLY BINDING SECTION:</b>	
<b>Appendix 1:</b>	
<b><i>Explanation</i></b>	<b>30</b>
<b>Appendix 2:</b>	
<b><i>Detailed contents list</i></b>	<b>53</b>

#### **ⓘ 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

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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; and
- section 45C of the ITAA 1936.

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

## Class of entities

3. The class of entities to which this Ruling applies is the unitholders of Energy Infrastructure Trust (EIT) who are registered on the Register of EIT on the date for determining entitlement to the proposed return of capital.

## 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 26 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

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8. This Ruling applies from 1 July 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

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9. 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:

- application for Class Ruling dated 23 December 2009; and
- further correspondence received on 5 January 2010, 19 February 2010, 12 March 2010 and 30 April 2010.

**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. EIT is an open-ended, unlisted unit trust that was established in February 2003.

11. EIT is treated as a company for income tax purposes as it made a choice, pursuant to sections 713-130 and 703-50, to be treated as the head company of a consolidated group for income tax purposes from 1 April 2005.

12. EIT has 375,844,724 fully paid units of a single class on issue.

13. All of the EIT units are held by Australian residents for tax purposes.

14. EIT's equivalent of a share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

15. The principal activity of EIT is acquiring, developing and owning investments in energy and utility infrastructure in Australia.

16. The main sources of EIT's profits to date has been:

- gains from the disposal of investments; and
- interest income.

17. EIT considers that it has current frankable retained earnings of approximately \$71,110,605. This is made up of \$36,035,966 attributable to the sale of shares in Condamine Power Station Pty Ltd which was completed on 7 October 2009. Pursuant to the EIT distribution policy, this will not be treated as being available for potential distribution until the year ending 30 June 2011 to match the year of distribution with the period in which the attendant tax liability is paid. The balance of \$35,074,639 is attributable to an undistributed portion of the profits from the previous sale of certain shares.

18. EIT's distribution policy in relation to half-yearly distributions is as follows:

- A determination is made as to whether EIT has surplus cash holdings – surplus in that the amount of cash exceeds that required to meet its existing obligations and investment opportunities.
- If it is determined that EIT does not have surplus cash holdings then no distribution is made. This was the case in relation to the period ended 30 June 2005.
- If it is determined that EIT has excess cash holdings then a distribution may be made.
- The components are generally determined in the following order:
  - Realised 'taxable' profits to the extent that they can be paid as franked distributions.
  - Realised profits that are 'not taxable' due to offsetting tax losses.
  - The balance as capital (being principal payments received on loans to entities EIT has invested in and the return of original capital in assets which have since been sold).

19. EIT's current cash holdings total \$313,184,373, some of which is surplus to its needs. The cash holdings have arisen from:

- a unit issue to investors in September 2009 which raised \$112,470,000; and
- the following cash receipts in relation to the sale of the shares in Condamine Power Station Pty Ltd:
  - proceeds from the sale of the shares of \$20,323,984. EIT acquired these shares for a cost of \$1,000;
  - repayment of the principal of a loan made to Condamine Power Station Pty Ltd of \$168,595,185; and
  - payment of capitalised interest of \$31,265,421 upon discharge of the loan facility.

20. EIT is primarily financed with capital. External debt funding is not raised by EIT (other than for short term bridging purposes), rather external debt funding is raised at the investment level.

21. EIT intends to return \$45.5 million of capital to its unitholders. This represents a return of capital of \$0.121 per unit.

22. The units in EIT have been issued at prices ranging from \$1.00 to \$2.2867, and have traded at prices ranging from \$1.10 to \$2.4450. EIT has previously made minimal returns of capital.

23. EIT believes that the return of capital is attributable to the capital released from the repayment of the loan made to Condamine Power Station Pty Ltd.

24. The return of capital would be recorded in the accounts as follows:

	Debit	Credit
Unitholder funds	\$45.5 million	
Distribution declared		\$45.5 million
<i>Declaration of the return of capital</i>		
Distribution declared	\$45.5 million	
Cash at bank		\$45.5 million
<i>Payment of the declared return of capital</i>		

25. From EIT's perspective, the commercial benefits of the return of capital include:

- improving the rate of return to unitholders (as the return on cash deposits is significantly less than the returns from infrastructure investments); and
- meeting the expectations of some unitholders who have communicated a strong preference for the return of surplus cash because of economic conditions.

26. It is currently proposed that the profits realised on the sale of the shares in Condamine Power Station Pty Ltd and the balance of the interest income on the loan from EIT to Condamine Power Station Pty Ltd not previously distributed will be distributed in the next year ending 30 June 2011, the year in which the related tax liability will be paid.

## **Ruling**

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27. The proposed return of capital by EIT will not be a dividend as defined in subsection 6(1).

28. The Commissioner will not make a determination under section 45A that section 45C applies to the proposed return of capital by EIT.

29. The Commissioner will not make a determination under section 45B that section 45C applies to the proposed return of capital by EIT.

## Appendix 1 – Explanation

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**ⓘ** *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.*

### Unit Trust considerations

30. As a consequence of the consolidation rules in Division 713 of the ITAA 1997, section 45B of the ITAA 1936 can apply to particular types of trusts. This is due to the fact that certain corporate unit trusts and public trading trusts are treated like a company for tax purposes when they elect to become the head company of a consolidated group. For these trusts the modifications to the applied law pursuant to section 713-140 of the ITAA 1997 provide that a reference to a dividend in the ITAA 1936 and ITAA 1997 includes a reference to a distribution from the trust out of profits and a reference to a share capital account includes a reference to the amount of the trust estate that is not attributable to profits.

31. In the present circumstances, these modifications will result in the distribution from the trust out of profits being treated as a dividend as defined in the ITAA 1936 and ITAA 1997. Further, it will result in an amount of the trust estate that is not attributable to profits being treated in the same way as a share capital account.

32. Sections 713-130, 713-135 and 713-140 of the ITAA 1997 provide that the applied law involves corresponding treatment of analogous characteristics, things and persons relating to a trust to those of a company. For the purposes of simplicity, this Ruling will use the terminology that applies to companies where the trust has engaged in an equivalent transaction but retaining the distinction that unit holders, rather than shareholders, will receive the proposed payment.

### Dividend

33. 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).

34. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, later paragraphs in this subsection exclude certain items from being a dividend for tax purposes.

35. Relevantly, paragraph (d) of subsection 6(1) 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

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

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

37. In the present circumstances an arrangement of the type contemplated by subsection 6(4) is not apparent. Accordingly, subsection 6(4) will have no application in respect of the proposed return of capital.

38. The proposed return of capital will be recorded as a debit to EIT's unit holder funds account, which is equivalent to a share capital account in these circumstances. As this account is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (a) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies. Accordingly, the proposed return of capital will not constitute a dividend.

### **Anti-avoidance provisions**

#### ***Sections 45A and 45B***

39. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of the return of capital amount received by the shareholders as an unfranked dividend.

#### ***Section 45A – streaming of dividends and capital benefits***

40. 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.

41. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) will be provided to participating unit holders under the capital return, the circumstances of this are that the capital return will be provided pro-rata to all unit holders which indicates that there will be no streaming that would be the equivalent of capital benefits being streamed to some shareholders and dividends being streamed to other shareholders.

42. Accordingly, section 45A has no application to the return of capital.

### ***Section 45B – schemes to provide capital benefits***

43. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. Specifically, the provision 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 (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, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

These conditions are considered in paragraphs 44 to 50 of this Ruling.

### ***The scheme***

44. A scheme for the purpose of section 45B is defined under subsection 177A(1) to include:

- any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- any scheme, plan, proposal, action, course of action or course of conduct.

45. The arrangement involving EIT's return of capital to its unit holders will constitute a 'scheme' for the purposes of section 45B.

***A person is provided with a capital benefit by a company***

46. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). It states that a person is provided with a capital benefit if:

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

47. As EIT's return of capital will be recorded as a debit to the unit holder funds account, its unitholders will receive a distribution equivalent to a distribution of share capital. Therefore, they will be provided with a capital benefit under paragraph 45B(5)(b).

***The relevant taxpayer obtains a tax benefit***

48. A shareholder 'obtains a tax benefit' as defined in subsection 45B(9) of the ITAA 1936 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 of the ITAA 1936:

- 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 instead had been a dividend.

49. As discussed in paragraph 47 of this Ruling, the payment of the return of capital to shareholders will be a capital benefit. In the event that the return of capital did represent a dividend rather than a capital benefit, a unitholder would pay less tax, or pay tax at a later time as a result of being assessed under the CGT provisions rather than being assessed under subsection 44(1) as a dividend. Consequently, the receipt of the capital benefit will represent a tax benefit.

### ***Relevant circumstances of the scheme***

50. Having regard to the relevant circumstances of the scheme as listed under subsection 45B(8), it cannot be concluded that either EIT or EIT unit holders will enter into or carry out the proposed scheme for the purpose of enabling the EIT unit holders to obtain a tax benefit. It cannot be said that the return of capital is attributable to the profits of EIT, nor does EIT's pattern of distributions indicate that the return of capital is being made in substitution of dividends. Similarly, the manner in which the proposed scheme is to be carried out, and the form and substance of the proposed scheme, do not indicate that the proposed capital return will be made in substitution for dividends.

### ***Conclusion***

51. After having regard to the relevant circumstances of the scheme, as listed in subsection 45B(8), it is concluded that the proposed scheme to return capital to EIT unitholders is not being entered into for more than an incidental purpose of enabling shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the proposed return of capital.

### ***Application of section 45C***

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

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

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

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Relevant provision(s)	2
Class of entities	3
Qualifications	4
<b>Date of effect</b>	<b>8</b>
<b>Scheme</b>	<b>9</b>
<b>Ruling</b>	<b>27</b>
<b>Appendix 1 – Explanation</b>	<b>30</b>
Unit Trust considerations	30
Dividend	33
Anti-avoidance provisions	39
<i>Sections 45A and 45B</i>	39
<i>Section 45A – streaming of dividends and capital benefits</i>	40
<i>Section 45B – schemes to provide capital benefits</i>	43
<i>The scheme</i>	44
<i>A person is provided with a capital benefit by a company</i>	46
<i>The relevant taxpayer obtains a tax benefit</i>	48
<i>Relevant circumstances of the scheme</i>	50
<i>Conclusion</i>	51
Application of section 45C	52
<b>Appendix 2 – Detailed contents list</b>	<b>53</b>

## References

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- Previous draft:*
- Not previously issued as a draft
- Related Rulings/Determinations:*
- TR 2006/10
- Subject references:*
- capital benefits
  - dividend income
  - return of capital on shares
  - share capital
- Legislative references:*
- ITAA 1936
  - ITAA 1936 6(1)
  - ITAA 1936 6(4)
  - ITAA 1936 44(1)
  - ITAA 1936 45A
  - ITAA 1936 45A(2)
  - ITAA 1936 45A(3)(b)
  - 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(9)
  - ITAA 1936 45C
  - ITAA 1936 177A(1)
  - ITAA 1997
  - ITAA 1997 Div 197
  - ITAA 1997 703-50
  - ITAA 1997 Div 713
  - ITAA 1997 713-130
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### ATO references

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