


CR 2010/25 - Income tax: proposed return of capital: Minara Resources Limited

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Class Ruling

Income tax: proposed return of capital: Minara Resources Limited

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

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

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

If you rely on this ruling, 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:
- section 45B of the *Income Tax Assessment Act 1936* (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 ordinary shareholders of Minara Resources Limited (MRE) who receive a return of share capital consisting of cash under the scheme described in paragraphs 9 to 34 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 9 to 34 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 to the income year ending 30 June 2011. The Ruling continues to apply after 30 June 2011 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 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 26 March 2010 and attached documents; and
 - email and attached correspondence and documents from Deloitte Touche Tohmatsu, received on 7 May 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. MRE is an Australian publicly listed company. It is the holding company of a group engaged in the business of mining nickel and cobalt.

11. MRE shareholders are made up of:

- Australian residents- holding approximately 29.05per cent of the interests in MRE; and
- Foreign residents- holding approximately 70.95 per cent of the interests in MRE.

12. MRE holds 100% of the shares in Minara Resource Holdings Pty Ltd (MRH), which holds 100% of the shares in Murrin Murrin Holdings Pty Ltd (MMH). The principal activity of MMH and that of the MRE group is the operation of the Murrin Murrin nickel and cobalt open pit mines and processing facilities (the Murrin Murrin Project). MRE holds a 60% interest in the Murrin Murrin Project through MMH.

13. The directors of MRE have decided to recommend a return of capital to shareholders in the amount of \$0.095 per share. Based on current shareholding, the total amount of the distribution will be \$110,939,434.

14. MRE is debiting the entire amount of the return of capital against the amount standing to the credit of the contributed capital account.

15. The return of capital is applied equally to each holder of MRE shares who are on the MRE share register on the record date, by way of cash distribution in proportion to the number of shares held on that date.

16. The following accounting entry accounts for the payment to shareholders:

DR Contributed Equity	\$110,939,434	
CR Cash at bank		\$110,939,434

17. The return of capital will effectively be sourced from funds raised from shareholders in 2008, which the group considers to be excess to its current requirements.

18. During the year ended 31 December 2008, the group's cash balance began to fall as a result of falling commodity prices, and inability to secure bank funding on acceptable terms.

19. In October 2008, MRE announced a rights issue for the purpose of raising approximately \$210 million before costs.

20. Under the terms of the rights issue, eligible shareholders who were on the company's share register at 5.00 pm on 10 November 2008 would be entitled to apply for three New Shares for every two shares held, at an issue price of \$0.30 each per New Share.

21. MRE planned to use the funds from the rights issue to:
- meet ongoing commitments;
 - repay short term funding;
 - fund necessary maintenance on the plant to allow it to keep operating and meet any necessary capital expenditure; and
 - provide a buffer in the event of further operating losses.
22. Of the capital raised from shareholders, the amount of \$202 million was paid to MMH as an interest-free loan.
23. The actual amounts paid in respect of repayment of short term funding and capital expenditure were lower than the indicative amounts advised to shareholders, resulting in a higher amount being available for working capital and funding of ongoing operations.
24. The following table sets out the indicative use of funds from the capital raising as advised to shareholders, as against the actual use of funds :
- | Use of funds | Indicative amount | Actual amount |
|---|-------------------|---------------|
| Repayment of amount outstanding under short term funding | \$73 million | \$70 million |
| Capital expenditure | \$23 million | \$21 million |
| Underwriting fees and other costs associated with the Offer | \$8 million | \$8 million |
| Working capital and funding for ongoing operations | \$106 million | \$111 million |
25. Commodity prices subsequently improved, and the market has substantially recovered.
26. The loan funds were retained by MMH in order to fund a proposed capital purchase. MRE submitted a bid for the asset in late 2009. However, the bid was not successful.
27. The funds retained by MMH are now considered to be excess to requirements.
28. The return of capital will be funded by repayment of the loan to MMH to the extent of the amount to be distributed to the shareholders of MRE. Thus the return of capital will effectively be sourced from the balance of the funds raised by the capital raising in 2008.
29. MRE has confirmed that its share capital account (as defined in section 975-300 of the *Income Tax Assessment Act 1997* (ITAA 1997)) is not tainted (within the meaning of Division 197 of the ITAA 1997).

30. It is expected that the amount of the proposed distribution will not exceed the cost base of the shares.

31. MRE has a history of paying out its profits as dividends to shareholders, notwithstanding that the group as a whole is in an accumulated loss position for accounting purposes. MRE paid dividends to shareholders from 2005 to 2008. If it continues to sustain profitable operations, it intends to return to its practice of paying dividends to shareholders in each year.

32. MRE's Statement of Financial Position as at 31 December 2009 shows total shareholders' equity of \$885,637,000, consisting of contributed share capital of \$982,444,000, reserves of \$934,000 and accumulated losses of \$97,741,000.

33. For the consolidated group, the Statement of Financial Position shows total shareholders' equity of \$866,544,000, consisting of contributed share capital of \$982,444,000, reserves of \$934,000, an allowance for minority interest of \$4,831,000 (consisting of interest in retained profits at the beginning of the financial period of \$4,733,000 and interest in profit from ordinary activities after income tax of \$98,000) and accumulated losses of \$112,003,000.

34. MRE's Statement of Financial Performance also records an operating loss of \$6,170,000 (after tax \$4,543,000) for the year ended 31 December 2009. The consolidated group records an operating profit of: \$37,326,000 (after tax \$48,535,000).

Ruling

35. The Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or any part, of the return of capital to MRE shareholders. Therefore the distribution will not be considered to be a dividend.

Commissioner of Taxation

7 July 2010

Appendix 1 – Explanation

① *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.*

36. Section 45B is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C applies to treat all or part of a return of capital payment as an unfranked dividend.

37. Section 45B applies where certain amounts of a capital nature, including a return of capital, are provided to shareholders in substitution for dividends. Subsection 45B(2) sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) that section 45C applies. These conditions are that:

- there is a scheme under which a person is provided with a capital benefit by a company;
- under the scheme a person (the relevant taxpayer) who may or may not be the person provided with the capital benefit, obtains a tax benefit; 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 (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

Each of these conditions is considered below.

Scheme

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

39. Accordingly, the proposed return of capital is a 'scheme' for the purposes of paragraph 45B(2)(a).

Capital benefit

40. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). A person is provided with a capital benefit if:

- ownership interests in a company are issued to the person;
- there is a distribution to the person of share capital; or

- the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest held by that person.

As MRE proposes to debit the distribution to its share capital account, its shareholders will receive a capital benefit.

Tax benefit

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

42. Ordinarily, a return of capital would be subject to tax under the capital gains and losses provisions of the income tax law. Unless the amount of the proposed distribution exceeds the cost base of the shares (which MRE has advised is not expected to occur) there will only be a cost base reduction under capital gains tax (CGT) event G1 (section 104-135 of the ITAA 1997). This will happen if the shareholder is a resident of Australia for income tax purposes, or a non-resident whose shares are CGT assets having the necessary connection with Australia (category 5 of the table in section 136-25 of the ITAA 1997). Shareholders would therefore obtain a 'tax benefit', as defined in subsection 45B(9) of the ITAA 1936, under the arrangement.

43. As the conditions of paragraphs 45B(2)(a) and (b) are satisfied, and the shareholders will obtain a tax benefit, the remaining condition in paragraph 45B(2)(c), that is, whether the requisite degree of purpose (of enabling MRE shareholders to obtain a tax benefit) is present, must be considered.

Relevant circumstances

44. Paragraph 45B(2)(c) sets out an objective purpose test, having regard to 'the relevant circumstances of the scheme', 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.

45. Subsection 45B(8) sets out a list of relevant circumstances to be considered in determining whether the objective purpose test is satisfied. The list is not exhaustive, and not all factors listed will be relevant to every scheme. Under the arrangement, the relevant taxpayers are MRE shareholders.

46. Paragraph 45B(8)(a) refers to the extent to which a capital benefit is attributable to capital or to realised and unrealised profits of the company and its associates. The return of capital will be funded from the partial repayment of the loan presently owed by MMH to MRE. The loan was largely comprised of the funds received by MRE from the capital raising in December 2008, which are now excess to requirements. The capital is wholly sourced from shareholder's contributed capital and therefore the distribution is attributed to the share capital account. This factor tends against finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

47. Paragraph 45B(8)(b) refers to the pattern of distribution of dividends, bonus shares and returns of paid up capital by the company or its associates:

- since 2005, when it first commenced paying dividends, MRE has a history of paying out its profits as dividends, notwithstanding the fact that the group as a whole, and various companies within the group, are in an accumulated loss position for accounting purposes;
- In the 2005 income year, MRE made a capital payment to its shareholders based on its receipt of a share of a settlement payment in respect of claims in relation to construction of plant;
- Upon returning to sustainable profitable operations, the MRE board intends to return to its practice of paying dividends to shareholders.

The company's history of dividend payments and capital distribution does not support a finding that the capital distribution under the arrangement represents a dividend substitution. This factor tends against finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

48. Paragraph 45B(8)(c) is concerned with the extent to which the distribution would enable shareholders to recoup capital losses that, apart from the scheme, would be carried forward to a later year of income. MRE has advised that, having regard to the history of its share price, it does not expect that any shareholder will, as a result of the scheme, derive capital gains that they would be able to recoup against capital losses. This factor therefore tends against finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

49. Paragraph 45B(8)(e) requires consideration of whether the shareholders of the company are non-residents. The implication of non-residency is that it would normally point towards a tax preference for a distribution of capital over profit. The major shareholder of MRE is a non-resident. This factor tends towards finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

50. Paragraph 45B(8)(f) of the ITAA 1936 directs attention to the cost base (for the purposes of ITAA 1997) of the shares. Where the cost base is similar to or greater in value than the capital benefit provided, the capital distribution will not expose the relevant taxpayer to a capital gain. It is expected that the cost base of the shares will significantly exceed the value of the maximum capital benefit to the shareholders of 9.5c. This factor therefore tends towards finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

51. Paragraph 45B(8)(h) requires consideration of whether the shareholders' equity interest in the company will be the same before and after the distribution of share capital. After the capital distribution the proportional interests held by each shareholder will be the same as that which would have been held if an equivalent dividend had been paid. This factor tends towards finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

52. It is considered that the factors set out in paragraphs 45B(8)(d), (g), (i) and (j) do not apply to the arrangement set out in paragraphs 9 to 34 of this Ruling.

53. Paragraph 45B(8)(k) requires that regard be had to any of the matters referred to in subparagraph 177D(b)(i) to (viii). These are matters of reference for the 'dominant purpose' test in Part IVA. However, in the context of section 45B, they facilitate the 'more than incidental purpose' test and do not introduce a different test.

54. The matters dealt with in subparagraphs 177D(b)(i) to (viii) are dealt with in paragraphs 55 to 62 of this Ruling.

55. Subparagraph 177D(b)(i) of the ITAA 1936 refers to the manner in which the scheme was entered into or carried out. The return of capital is the result of a decision of the directors to seek shareholder approval to return to all shareholders an amount of capital that is considered to be surplus to requirements. It will be put to the shareholders for their approval in accordance with the requirements of the *Corporations Act 2001*.

56. Subparagraph 177D(b)(ii) refers to the form and substance of the scheme. The amount of capital to be returned to shareholders corresponds to the balance of capital funds raised in December 2008 which are now considered to be excess to requirements. Based on the information provided by MRE, the substance of the scheme accords with its form.

57. Subparagraph 177D(b)(iii) directs attention to the time at which the scheme was entered into and the length of the period during which it was carried out. The capital to be returned to the shareholders substantially represents the balance of funds raised to provide for adverse market conditions, and retained in order to fund a bid (which proved to be unsuccessful) for the purchase of an asset. The company now has no need for the funds raised. The timing of the share capital reduction with the occasion of the directors' determination that the share capital is surplus to company requirements points to a non-tax purpose.

58. Subparagraph 177D(b)(iv) requires identification of the tax results of the scheme if section 45B were not to apply. Because the distribution will be debited against MRE's share capital account, the distribution falls outside the definition of dividend in subsection 6(1), and is not received as income in the shareholders' hands. Instead, under CGT Event G1, the cost base of the shares for those shareholders subject to CGT will be reduced by the amount of the capital returned.

59. Subparagraph 177D(b)(v) directs attention to any change in the financial position of the shareholders that results, will result, or may reasonably be expected to result, from the share capital reduction scheme. The shareholders' financial position will change as they will receive a cash distribution of up to 9.5c per share held, while their proportionate interests in the company will remain essentially the same.

60. Subparagraph 177D(b)(vi) refers to taking into consideration any change in the position of any person connected with the shareholders. In general terms, MRE will be the only other party whose financial position will change as a result of the reduction of share capital. The result of the return of capital will be that MRE will divest itself of the amount of value represented by the amount of the capital returned. However, it has no need of the funds. An indirect result may be the forestalling of shareholder demand for a franked dividend, and the associated need for MRE to ensure that it has sufficient franking credits to make such a franked distribution. The return of capital will not be funded out of new or existing debt. Rather, it will be funded via the repayment to MRE of funds loaned to MMH. Therefore the return of capital will have no effect on MRE's gearing ratio.

61. Subparagraph 177D(b)(vii) directs attention to any 'other' consequence of the return of capital scheme for the shareholders or the company. This requires consideration of the nature of the company's business and how this impacts on its ability to pay dividends, as well as objective shareholder and 'market' expectations in relation to MRE's distributions. Payment of the return of capital will not impact on MRE's ability to pay dividends. It is a payment out of excess funds, and will not affect the profitability of the company. Given the company's history of paying dividends and its previous return of capital to shareholders, it is considered that the return of capital in this instance will align with shareholder and market expectations.

62. Subparagraph 177D(b)(viii) requires consideration of the nature of any connection between the shareholders and MRE. Generally, a company will manage its enterprise in the interests of the shareholders who, in turn, benefit from corporate distributions. Ordinarily, whether a distribution takes the form of capital or profits is a decision made in the interest of both shareholders and the business of the company, as these interests converge. There is nothing to indicate that that is not the case in relation to the scheme.

63. In summary, although the shareholders obtain a tax benefit under the scheme, the form and substance of the scheme is to effect a return to shareholders of capital that is excess to MRE's requirements. This is in line with MRE's general practice as reflected in its payment of dividends and the previous return of capital to shareholders. The factors set out in subparagraphs 177D(b)(i) to (viii) are not considered to incline towards a conclusion that the requisite degree of purpose exists.

64. In view of MRE's history of returning profits and excess capital to shareholders, there are objective and commercial reasons why MRE would choose to make the capital distribution.

65. Having regard to the relevant circumstances of the scheme, it is concluded that the arrangement as described will not be entered into for a more than incidental purpose of obtaining a tax benefit for MRE shareholders.

66. Therefore, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the distribution proposed under the arrangement.

Appendix 2 – Detailed contents list

67. 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:

- capital benefit
- dividend substitution
- return of capital on shares

Legislative references:

- | | |
|-----------------------|---------------------------|
| - ITAA 1936 | - ITAA 1936 45B(8)(e) |
| - ITAA 1936 6(1) | - ITAA 1936 45B(8)(f) |
| - ITAA 1936 45B | - ITAA 1936 45B(8)(g) |
| - ITAA 1936 45B(2) | - ITAA 1936 45B(8)(h) |
| - ITAA 1936 45B(2)(a) | - ITAA 1936 45B(8)(i) |
| - ITAA 1936 45B(2)(b) | - ITAA 1936 45B(8)(j) |
| - ITAA 1936 45B(2)(c) | - ITAA 1936 45B(8)(k) |
| - ITAA 1936 45B(3) | - ITAA 1936 45B(9) |
| - ITAA 1936 45B(5) | - ITAA 1936 45C |
| - ITAA 1936 45B(8) | - ITAA 1936 Pt IVA |
| - ITAA 1936 45B(8)(a) | - ITAA 1936 177A(1) |
| - ITAA 1936 45B(8)(b) | - ITAA 1936 177D(b)(i) |
| - ITAA 1936 45B(8)(c) | - ITAA 1936 177D(b)(ii) |
| - ITAA 1936 45B(8)(d) | - ITAA 1936 177D(b)(iii) |
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| | - ITAA 1997 |
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