# *CR 2010/3 - Income tax: return of capital: Lion Selection Limited*

# Class Ruling

## Income tax: return of capital: Lion Selection 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 provision(s) 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; and
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All references are to the ITAA 1936 unless otherwise stated.

### Class of entities

3. The class of entities to which this Ruling applies consists of the ordinary shareholders of Lion Selection Limited (Lion) who:

(a) were listed on the share register of Lion as at the Record Date (7 December 2009) for the cash distribution;

(b) were residents of Australia as defined in subsection 6(1) on that date; and

(c) held their Lion shares on capital account on that date.

In this Ruling, a person belonging to this class of entities is referred to as a 'Lion shareholder'.

### Qualifications

4. The Commissioner makes this Ruling based on the precise scheme 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 25 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.

## Date of effect

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

9. The following description of the scheme is based on information provided by the applicant.

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

10. On 24 June 2009, Lion announced a restructure. The key transactions under the restructure were:

- the demerger of 100% of the ordinary shares in Lion Selection Group Ltd (a wholly-owned subsidiary of Lion) to the shareholders of Lion;
- the payment of a cash distribution of 10 cents per share by way of a return of capital to the shareholders of Lion;
- following the demerger, the acquisition of 100% of the ordinary shares in Lion by Catalpa Resources Ltd (Catalpa) pursuant to a Scheme of Arrangement under Part 5.1 of the *Corporations Act 2001*.

11. Lion was, at the time of the restructure, an Australian resident company listed on the Australian Securities Exchange (ASX). Lion was the head company of a consolidated tax group for the purposes of Part 3-90 of the ITAA 1997.

12. Lion is a resource company. Before the restructure, it had invested in global mining companies, with operations focussed in Australia, Africa and South East Asia. Lion had a diversified investment portfolio which includes interests in companies that undertake exploration and mining for gold, copper, nickel and other base metals.

13. In addition to its investment portfolio, Lion had a 30% interest in the Cracow joint venture, an operational gold mine in Queensland and an interest of approximately 46.9% in Catalpa.

14. On 25 September 2008, Lion announced an off-market share buy-back of up to 50% of its issued shares as part of its capital management strategy.

15. Immediately before the restructure, Lion had 88,029,353 fully paid ordinary shares on issue.

16. There were no other ownership interests in Lion just before the restructure.

### The cash distribution

17. Lion proposed to debit the cash payment of $8.8 million wholly against its share capital account.

18. Lion shareholders voted at a general meeting on 17 November 2009 to approve an ordinary resolution to reduce the share capital of Lion, and distribute it at the rate of 10 cents per share as a cash distribution.

19. Lion paid the cash distribution on 10 December 2009 (Payment date) to all entities who owned Lion shares on the Record Date (7 December 2009).

20. The cash distribution of approximately $8.8 million was funded from surplus cash reserves. Lion considered that the cash would be in excess of its needs following its merger with Catalpa.

21. Lion has confirmed that its share capital account (as defined in section 975-300 of the ITAA 1997) is not tainted (within the meaning of Division 197 of the ITAA 1997).

22. The cash distribution was paid to all shareholders equally and did not result in any shares being cancelled.

23. The shareholders of Lion were at the time of the cash distribution a mix of individuals, companies, superannuation funds and foreign residents.

24. Lion has only paid one dividend, on 22 February 2008. This dividend was fully franked at 3 cents per share ($5,731,000).

25. At the time of announcing the restructure, Lion had expected to have retained earnings of $1.1 million as at the Record Date.

## Ruling

### Cash distribution is not a dividend for income tax purposes

26. The cash distribution to the Lion shareholders is not a dividend, as defined in subsection 6(1).

### The application of sections 45A, 45B and 45C to the cash distribution

27. The Commissioner will not make a determination under section 45A that section 45C applies to the cash distribution.

28. The Commissioner will make a determination under section 45B that section 45C applies to $1.1 million of the cash distribution. Accordingly, part of the cash distribution paid to Lion shareholders will be taken to be an unfranked dividend paid out of Lion's profits for Australian income tax purposes under section 45C.

### Capital gains tax

29. CGT event G1 (section 104-135 of the ITAA 1997) happened when Lion paid the cash distribution to a Lion shareholder in respect of a Lion share that they owned at the Record Date and continued to own at the payment date.

**Commissioner of Taxation**
24 February 2010

# Appendix 1 – Explanation

***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.***

### Cash distribution is not a dividend for income tax purposes

30. 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).

31. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) excludes a distribution from the meaning of 'dividend' if the amount of a distribution is debited against an amount standing to the credit of the company's share capital account.

32. The term 'share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

33. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted.

34. The cash distribution was recorded as a debit to Lion's share capital account. As the share capital account of Lion is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies. Accordingly, the cash distribution does not constitute a dividend.

### The application of sections 45A, 45B and 45C to the cash distribution

35. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfranked dividend that is paid by the company out of profits to the shareholder.

#### *Section 45A*

36. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the capital benefits than other shareholders (the Disadvantaged Shareholders) and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

37. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in subsection 45A(3) to include the distribution to the shareholder of share capital. The return of share capital in the present case by Lion to its shareholders, through the cash distribution, will constitute the provision of a capital benefit. However, as Lion will make a pro-rata return of capital to all of its shareholders in respect of their ordinary shares in Lion, there will be no streaming of capital benefits to some shareholders and not to others.

38. Therefore, section 45A will have no application in respect of the cash distribution. Accordingly, 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***

39. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. The effect of such a determination is that all or part of the distribution of capital received by the shareholder is treated as an unfranked dividend.

40. In broad terms, section 45B applies where:

(a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));

(b) 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

(c) 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)).

41. Each of these conditions is considered below.

*Scheme*

42. 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.

43. Accordingly, the cash distribution to the Lion shareholders constitutes a scheme for the purposes of paragraph 45B(2)(a).

*Capital benefit*

44. 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:

- an ownership interest in a company is 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 (which may or may not be the same interest) held by that person.

45. As the amount of the cash distribution was debited to Lion's share capital account, its shareholders are taken to have been provided with a capital benefit under paragraph 45B(5)(b).

*Tax benefit*

46. A taxpayer '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 had instead been a dividend.

47. Ordinarily, a distribution of capital would be subject to the capital gains tax provisions of 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 (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 resident 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, be subject to withholding tax under section 128B of the ITAA 1936. Accordingly, Lion shareholders obtained tax benefits from the cash distribution.

*Relevant circumstances*

48. 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.

49. 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.

50. The relevant circumstances under subsection 45B(8) include the circumstances of the company and the tax profile of the shareholders. In this instance, the circumstances described in paragraphs 45B(8)(c), (d), (e) and (i) do not incline for or against a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(g) (which is repealed) and (j) (pertaining to demergers) are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b), (f), (h) and (k).

51. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital or profits (realised and unrealised) of the company or an associate. This factor refers to the extent to which the distribution is attributable to the profits of the company. Paragraph 1.35 of the Explanatory Memorandum to the Taxation Laws Amendment (Company Law Review) Bill 1998 states the following:

> … if a company makes a profit from a transaction, for example the disposal of business assets, and then returns capital to shareholders equal to the amount of the profit, that would suggest that the distribution of capital is a substituted dividend. On the other hand, if a company had disposed of a significant part of its business at a profit and distributed an amount of share capital which could reasonably be regarded as the share capital invested in that part of the business, the distribution of capital would not be seen as a substituted dividend because no amount would be attributable to profits.
>
> …

52. There is no evidence that Lion has released share capital from the disposal of a substantial part of its business and distributed an amount of share capital which could reasonably have been regarded as the share capital invested in that part of the business.

53. In objectively considering this relevant circumstance, regard has been had to the nature of contributed capital and profit together with the availability of each of them to Lion. Lion has not released share capital from a disposal of a substantial part of its business and has not paid any dividends from its available profits, but debited the entire cash distribution to its share capital account. It follows that at least part of the cash distribution is regarded as a substituted dividend because an amount is attributable to profits.

54. Lion's proposal that the entire amount of the cash distribution would have been attributable to capital would not be a reasonable attribution between profit and capital.

55. The Commissioner considers that a reasonable attribution of the profit component in the cash distribution would be the amount of the retained earnings of $1.1 million.

56. The circumstance required to be considered under paragraph 45B(8)(a) is strongly indicative of a purpose of enabling a taxpayer to obtain a tax benefit.

57. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or by associates (within the meaning in section 318) of the company. Lion states that it has a policy of paying dividends where retained earnings are available. Lion last paid a dividend on 22 February 2008 of 3 cents per share ($5,731,000). Although it had available retained earnings of $1.1 million, Lion did not pay a dividend as part of its $8.8 million payment to its shareholders. Consequently, the cash distribution would appear to be, at least in part, attributable to profits as it could have distributed profits for part of the cash distribution.

58. Paragraph 45B(8)(f) of the ITAA 1936 directs attention to whether the cost base (for the purposes of the ITAA 1997) of the relevant ownership interest is not substantially less than the value of the capital benefit. Where the cost base of the ownership interest is similar or greater in value than the capital benefit provided, the capital benefit will not expose the relevant taxpayer to a capital gain under CGT event G1 (section 104-135 of the ITAA 1997). Lion has acknowledged the possibility that the cost bases of the relevant shares held by Lion shareholders may be greater than the value of the capital benefit represented by the cash distribution. However, for many of the shareholders, their cost base is greater than the capital benefit. For these latter shareholders, the cash distribution will not cause a capital gain from CGT event G1 to be made.

59. 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. Paragraph 1.35 of the Explanatory Memorandum to the Taxation Laws Amendment (Company Law Review) Bill 1998 further suggests that if the proportionate voting and other interests held by the taxpayer following the capital reduction are less than the interests held by the taxpayer prior to the reduction, this would suggest a genuine return of capital.

60. In this case after the cash distribution, the proportionate and voting interests *inter se* of each shareholder and *vis-à-vis* the company will remain unchanged. The effect is that the distribution of share capital is not economically dissimilar to an ordinary or special dividend where cash is received by a shareholder. This is considered indicative of the cash distribution being in substitution for a dividend.

61. 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, the timing of the scheme, its form and substance, and its financial and other implications for the parties involved.

62. Having regard to the relevant circumstances in paragraphs 45B(8)(a), 45B(8)(b), 45B(8)(f) and 45B(8)(h), it is concluded that the requisite degree of purpose of enabling a shareholder to obtain a tax benefit exists. The circumstances required to be considered under paragraph 45B(8)(k) have therefore not been separately considered.

63. Accordingly, the Commissioner will make a determination under paragraph 45B(3)(b) that section 45C applies to $1.1 million of the cash distribution. This equals 1.25 cents of the cash distribution received by each shareholder in respect of each Lion share.

### Capital gains tax

64. CGT event G1 (section 104-135 of the ITAA 1997) happened when Lion paid the cash distribution to a Lion shareholder in respect of a Lion share that they owned at the Record Date and continued to own at the payment date, and some or all of the cash distribution is not a dividend (as defined in subsection 995-1(1) of the ITAA 1997) or a deemed dividend under section 47 of the ITAA 1936.

65. Lion paid the entire cash distribution out of its untainted share capital account. The Commissioner will make a determination under paragraph 45B(3)(b) that section 45C applies in relation to a part (1.25 cents per share) of the cash distribution of 10 cents per share. Therefore, this part of the cash distribution will be taken to be a dividend, and will be included in the assessable income of a Lion shareholder under section 44.

66. The balance of the cash distribution (the non-assessable part) is not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

67. If the non-assessable part (8.75 cents per share) of the cash distribution is not more than the cost base of the Lion share at the payment date, the cost base and reduced cost base of the share will be reduced by the amount of the non-assessable part (subsection 104-135(4) of the ITAA 1997).

68. A Lion shareholder will make a capital gain if the amount of the non-assessable part is more than the cost base of the Lion share (subsection 104-135(3) of the ITAA 1997). The amount of the capital gain is equal to that excess.

69. If a Lion shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the Lion share are reduced to nil. A Lion shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3) of the ITAA 1997).

70. If the Lion share to which the cash distribution relates was acquired by a Lion shareholder at least 12 months before the payment, a capital gain from CGT event G1 happening 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.

# Appendix 2 – Detailed contents list

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## References

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- cash distribution on shares
- banking, finance & securities
- capital gains tax
- capitalisation
- CGT events
- CGT events G1-G3 - shares
- distributions
- finance
- income
- return of capital on shares
- share capital

*Legislative references:*

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
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- ITAA 1936 45B(3)(b)
- ITAA 1936 45B(5)
- ITAA 1936 45B(5)(b)
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- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1936 128B
- ITAA 1936 Pt IVA
- ITAA 1936 177A(1)
- ITAA 1936 177D(b)
- ITAA 1936 177D(b)(i)
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- ITAA 1936 177D(b)(vii)
- ITAA 1936 177D(b)(viii)
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- ITAA 1997 104-135(4)
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 Div 197
- ITAA 1997 Pt 3-90
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- ITAA 1997 995-1(1)
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001

*Other references:*

- Explanatory Memorandum to the Taxation Laws Amendment (Company Law Review) Bill 1998

ATO references

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