CR 2010/41 - Income tax: return of capital: in specie distribution of shares by Trafford Resources Limited

Class Ruling

Income tax: return of capital: in specie distribution of shares by Trafford Resources Limited

Contents Para

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997; and
- section 118-20 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies are the shareholders of Trafford Resources Limited (Trafford) who:

(a) own ordinary shares in Trafford and are registered on the Trafford share register on the Record Date 2 February 2010, being the date for determining entitlements to the Robust Resources Ltd (Robust) shares;

(b) hold those shares on capital account;

(c) are residents of Australia (as that term is defined in subsection 6(1) of the ITAA 1936) at the time the scheme is undertaken; and

(d) are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Trafford shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling this class of entities is referred to as 'participating Trafford shareholders.'

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- this Ruling may be withdrawn or modified.

Date of effect

8. This Ruling applies from 22 January 2010 to 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:

- Class Ruling Application dated 26 February 2010 from Bentleys (WA) Pty Ltd;
- Trafford Australian Securities Exchange (ASX) Release 'Trafford Rewards Shareholders' on 9 December 2009; and
- correspondence from Bentleys (WA) Pty Ltd dated 18 May 2010, 29 June 2010, and 19 July 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.

Background

10. Trafford is an ASX listed public company, incorporated in December 2004, whose activities involve mineral exploration.

11. As at 2 February 2010 there were 71,339,862 shares on issue in Trafford. Up to 88% of those shares were held widely on the ASX. The remaining 12% were held by directors of Trafford.

12. Since 19 October 2009 Trafford had held 10.8 million shares in Robust. Robust is an Australian public company listed on the ASX.

Distribution of Robust shares to the Trafford shareholders

13. In an ASX Release dated 9 December 2009 Trafford informed the market of its intention to make an in specie distribution of up to one-third (about 3.6 million shares) of its holding in Robust to Trafford shareholders subject to the necessary approvals being received. The Robust shares were to be distributed to the shareholders in Trafford on the basis of one Robust share for every twenty Trafford shares held.

14. The distribution of Robust shares to Trafford shareholders has been made to reward shareholders who maintained their confidence in Trafford during the share market collapse in 2008 and to give them a direct investment in Robust.

15. On 22 January 2010, a resolution was passed at the General Meeting of Shareholders to distribute 3.6 million Robust shares in specie to Trafford shareholders.

16. The record date for determining the entitlement to Robust shares was 2 February 2010.

17. The distribution of Robust shares to participating Trafford shareholders was completed on 5 February 2010.

18. The accounting entries to reflect the in specie distribution by Trafford were:

- $1,080,000 debited to Trafford's share capital account; and
- $5,013,000 against current year profits.

Given the 71,339,862 shares on issue, 1.514 cents per share has been treated as a return of capital and 7.027 cents per share has been treated as an unfranked dividend.

Other matters

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

20. Trafford has only used share capital to fund its investment in Robust.

21. Trafford has no knowledge of any capital losses that are available to its shareholders.

Ruling

Dividends

22. The amount of 1.514 cents per share debited to share capital under the scheme is not considered a 'dividend' as defined by subsection 6(1).

23. The amount of 7.027 cents per share debited against current year profits under the scheme will be considered a 'dividend' as defined by subsection 6(1).

Anti-avoidance provision – section 45B

24. The Commissioner will not make a determination under section 45B that section 45C applies to the capital benefit, or part of the benefit (being the shares in Robust) received by participating Trafford shareholders. Accordingly, no part of the $1,080,000 (1.514 cents per share) debited to the share capital account will be taken to be a dividend pursuant to subsection 45C(1).

Capital gains tax (CGT) consequences

25. CGT event G1 happened to a participating Trafford shareholder when Trafford made the distribution of Robust shares in respect of the Trafford shares that they owned at the Record Date and continued to own at the time of the distribution but only to the extent of that part of the distribution not taken to be a dividend under subsection 6(1) of the ITAA 1936 (section 104-135 of the ITAA 1997).

26. CGT event C2 happened when Trafford made the distribution of Robust shares to a participating Trafford shareholder who was registered as a Trafford ordinary shareholder on the Record Date but had ceased to own their Trafford shares at the time when the distribution was made (section 104-25 of the ITAA 1997).

27. Any capital gain made as a result of CGT event C2 happening to a former participating Trafford shareholder's right to receive the distribution is reduced by that part of the distribution (7.027 cents per share) included in the former participating Trafford shareholder's assessable income as a dividend under subsection 6(1) of the ITAA 1936 (section 118-20 of the ITAA 1997).

Commissioner of Taxation
11 August 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.

Dividends

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

29. A portion (1.514 cents per share) of the capital benefit (being the Robust shares) has been debited against Trafford's share capital account. Therefore, this portion of the distribution will not be a dividend for the purposes of subsection 6(1).

30. A portion (7.027 cents per share) of the capital benefit (being the Robust shares) has been debited against Trafford's current year profits. Therefore, this portion of the distribution will be a dividend for the purposes of subsection 6(1).

Anti-avoidance provision – section 45B

31. Section 45B is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C applies. The effect of such a determination is that all or part of the capital benefit (being the Robust shares) received by the Trafford shareholders under the scheme is treated as an unfranked dividend. Accordingly, the application of these two provisions to the scheme must be considered.

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

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- under the scheme, a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose), of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

33. The provision of capital benefit (being the shares in Robust) by Trafford constitutes a scheme within the broad meaning of that term.

Provided with a capital benefit

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

> A reference to a person being ***provided with a capital benefit*** is a reference to any of the following:
>
> (a) the provision of ownership interests in a company to the person;
>
> (b) the distribution to the person of share capital or share premium;
>
> (c) something that is done in relation to an ownership interest that has the effect of increasing the value of an ownership interest (which may or may not be the same interest) that is held by the person.

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

Tax benefit

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

- the amount of tax payable; or
- any other amount payable under the ITAA 1936 or the ITAA 1997,

by the taxpayer would, apart from the operation of section 45B:

- be less than the amount that would have been payable; or
- be payable at a later time than it would have been payable,

if the capital benefit had instead been a dividend.

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

Relevant circumstances

38. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the 'relevant circumstances' set out in subsection 45B(8) to determine whether any part of the scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit. However, the list of relevant circumstances in subsection 45B(8) is not exhaustive and regard may be had to other circumstances on the basis of their relevance.

39. The test of purpose is an objective one. The question is whether it would be concluded that a person who entered into or carried out the scheme did so for the purpose of obtaining a tax benefit for the relevant taxpayer in respect of the capital benefit. The requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

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

41. The relevant circumstance of a scheme under paragraph 45B(8)(a) includes the extent to which the capital benefit is attributable to capital or profits (realised or unrealised) of Trafford or its associates. Trafford has confirmed that it does not have any prior year profits and that the investment in Robust was entirely sourced out of share capital. The attribution under the scheme correctly reflects the extent of share capital and profit in the distribution to shareholders.

42. Paragraph 45B(8)(b) covers the relevant circumstance that includes the pattern of distributions of dividends and returns of capital by the company. Trafford has never generated an accounting profit in the previous financial years and therefore has not been in a position under the *Corporations Act 2001* to declare and distribute a dividend to Trafford shareholders. Therefore the in specie distribution cannot be said to be in any way a substitute for any distribution of Trafford, nor can it be viewed as a substitute for the absence of such distributions.

43. Paragraph 45B(8)(h) considers whether the shareholder's interest in the company is the same before and after the distribution of share capital. In this case, following the scheme, the proportionate and voting interests of each shareholder in the company will remain unchanged.

44. Having regard to the relevant circumstances of the scheme, set out in subsection 45B(8), it cannot be concluded that any of the parties to the scheme entered into or carried out the scheme for more than an incidental purpose of obtaining a tax benefit. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the capital benefit (being the shares in Robust).

CGT consequences

CGT event G1 – section 104-135

45. CGT event G1 (section 104-135 of the ITAA 1997) happens if a company makes a payment to a shareholder in respect of a share they own in the company and some or all of the payment (non-assessable part) is not a dividend, or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

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

47. Therefore, CGT event G1 happened to a participating Trafford shareholder in respect of the Trafford shares that they owned at the Record Date and continued to own at the time of the distribution of the Robust shares but only to the extent of that part of the distribution not taken to be a dividend under subsection 6(1) of the ITAA 1936 (the non-assessable part).

48. The non-assessable part of the return of capital is that part of the market value of the Robust shares received by the participating Trafford shareholder at the time of the distribution that is attributable to the Trafford shares reduced by the amount taken to be a dividend (7.027 cents per Trafford share).

49. As a result of CGT event G1 happening, if the non-assessable part of the distribution is equal to or less than the cost base of the Trafford share at the time of the distribution, the cost base and reduced cost base of each Trafford share is reduced (but not below nil) by the amount of the non-assessable part (subsection 104-135(4) of the ITAA 1997).

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

51. If a participating Trafford shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the Trafford share are reduced to nil.

52. A participating Trafford shareholder cannot make a capital loss when CGT event G1 happens (Note 1 to subsection 104-135(3) of the ITAA 1997).

53. 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 Trafford share was acquired at least 12 months before the date of distribution (subsection 115-25(1) of the ITAA 1997) and the other conditions in that Subdivision are satisfied.

CGT event C2 – section 104-25

54. The right to receive the distribution is one of the rights inherent in a Trafford share at the Record Date. If, after the Record Date but before the time of the distribution of Robust shares, a participating Trafford shareholder ceased to own some, or all, of their Trafford shares, the right to receive the distribution in respect of each of the shares disposed of was retained by the participating Trafford shareholder and is considered to be a separate CGT asset.

55. CGT event C2, in section 104-25 of the ITAA 1997, happened when the distribution of Robust shares was made and the participating Trafford shareholder's right to receive that distribution ended.

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

57. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds are the market value of the Robust shares received under the in specie distribution at the time of the distribution (subsection 116-20(1) of the ITAA 1997).

58. The cost base of the participating Trafford shareholder's right to receive the shares in Robust is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As no amount will have been paid for the right by the participating Trafford shareholder, the cost base of the right is likely to be nil. Therefore, for a participating Trafford shareholder, a capital gain equal to the market value of the Robust shares at the time of distribution is likely to arise.

59. However, any capital gain made when CGT event C2 happens will be reduced under the anti-overlap provisions contained in section 118-20 of the ITAA 1997 by the amount of the distribution (7.027 cents per Trafford share) that is included in the former participating Trafford shareholder's assessable income as a dividend under subsection 6(1) of the ITAA 1936.

60. As the right to receive the shares in Robust from Trafford was inherent in the Trafford share during the time that it was owned, the right is considered to have been acquired at the time when the Trafford share was acquired (section 109-5 of the ITAA 1997). Consequently, if the Trafford share was originally acquired by the former participating Trafford shareholder at least 12 months before the distribution, a capital gain made when CGT event C2 happens will be a discount capital gain (subsection 115-25(1) of the ITAA 1997) provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Cost base and time of acquisition of the Robust shares

61. The first element of the cost base and reduced cost base of the Robust shares acquired by a participating Trafford shareholder is the market value of the Robust shares at the time of the distribution by Trafford (subsection 112-20(1) of the ITAA 1997).

62. Under section 109-5 of the ITAA 1997, the participating Trafford shareholder acquired their Robust shares at the time when the distribution by Trafford happened.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

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

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- 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)(a)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997
- ITAA 1997 103-5
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 112-20(1)
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 118-20
- ITAA 1997 Div 230
- ITAA 1997 975-300
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001

ATO references

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