


# ***CR 2011/33 - Income tax: redemption of units: LinQ Resources Fund***

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## Class Ruling

### Income tax: redemption of units: LinQ Resources Fund

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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

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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 44(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 102T of the ITAA 1936;
- section 128B of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 116-20 of the ITAA 1997;
- section 118-20 of the ITAA 1997;
- section 855-10 of the ITAA 1997; and
- section 855-15 of the ITAA 1997.

All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

## Class of entities

3. The class of entities to which this Ruling applies is the unitholders of the LinQ Resources Fund (LRF) that:

- redeemed their units in LRF under the Withdrawal Tender described in the scheme part of this Ruling;
  - held their units in LRF on capital account on the Record Date; and
  - are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their units in LRF.
- (note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

4. In this Ruling, these unitholders are referred to as 'participating unitholders'.

## Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. 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 10 to 33 of this Ruling.

7. 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

9. This Ruling applies from 1 July 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

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

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

11. LRF is a registered managed investment scheme that was established in March 2002 and listed on the Australian Securities Exchange (ASX) on 20 January 2005.

12. LinQ Capital Limited (LCL) is the corporate trustee and responsible entity for LRF.

13. LRF primarily invests in small to medium sized resource companies both in Australia and abroad using various instruments including ordinary equity, convertible notes and call options.

14. With effect from 1 July 2008, LRF has been classified as a public trading trust within the meaning of section 102R of the ITAA 1936.

15. LRF has not made a choice, pursuant to section 713-130 and section 703-50, to be treated as the head company of a consolidated group for income tax purposes.

16. LRF's balance sheet as at 30 June 2010 provides the following relevant financial information:

Assets	303,921,000
Liabilities	17,345,000
<b>Net Assets</b>	<b>286,576,000</b>
Contributed equity	213,901,000
Reserves	-
Retained profits	72,675,000
Total minority interest	-
<b>Total Equity</b>	<b>286,576,000</b>

17. As at 21 September 2010, LRF had 242,717,752 fully paid units of a single class on issue with a total issued capital of \$214,646,579. This equates to an average issued capital of approximately \$0.88 per unit.

18. Most units in LRF were issued at a price of \$1.00 under the fund's initial public offering. The lowest price a unit has issued for is \$0.46. Since listing on the ASX in 2005, LRF has a history of making distributions to unitholders.

19. The unitholders in LRF are a mix of Australian resident individuals, companies, institutions and superannuation funds, as well as non-resident unitholders. Less than 5 per cent of the total issued units in LRF are held by entities without an Australian postal address.

## Proposal

20. On 25 August 2010, LCL, as responsible entity for LRF, announced proposals for a revision of the investment strategy of LRF and an offer to unitholders to redeem part or all of their unitholding in the fund (the Withdrawal Tender).

21. Both proposals were subject to unitholder approval, with the Withdrawal Tender being conditional upon approval by unitholders of amendments to the constitution of LRF to allow the Withdrawal Tender to be implemented. The relevant approvals were given at LRF's general meeting of unitholders on 8 October 2010.

22. The Withdrawal Tender was offered to allow unitholders who did not feel LRF's revised investment strategy suited their investment criteria an opportunity to redeem all or part of their unitholding without adversely affecting the interest of other unitholders.

## Withdrawal Tender

23. The Withdrawal Tender was conducted through a tender process that opened on 11 October 2010. All unitholders on the register on 23 August 2010 (Record Date) were invited to participate except for foreign resident unitholders if such an invitation would be prohibited in the relevant foreign jurisdiction. Only those units held continuously and beneficially from the Record Date to the Withdrawal Tender Closing Date (1 November 2010) were eligible to be redeemed under the Withdrawal Tender.

24. Participation in the Withdrawal Tender was voluntary. Hence eligible unitholders who did not wish to participate were not required to take any action. Non-participating unitholders will not receive any property, dividend or distribution.

25. Under the tender process, unitholders were able to tender their units for redemption by LCL at a discount or discounts of between 5 per cent and 15 per cent per unit, in increments of 0.5 per cent. In doing so, unitholders were permitted to submit tenders to sell different parcels of units at different percentage discounts.

26. The relevant discount was applied to LRF's net tangible assets per unit as calculated at 5.00pm on 5 November 2010.

27. Unitholders that tendered a discount percentage less than the accepted discount percentage determined by LCL were not accepted. Unitholders that tendered a discount percentage greater than the accepted discount percentage were accepted in full and received the Withdrawal Tender Price per unit for each unit redeemed.

28. If the number of units tendered that satisfied the Withdrawal Tender criteria exceeded the number of units LCL determined to redeem, unitholders with tenders equal to the accepted discount percentage would be scaled back on a pro-rata basis.

29. On 8 November 2010, LRF announced the results of the Withdrawal Tender were as follows:

- the accepted discount percentage was 15 per cent;
- all valid tenders made at a discount of less than 15 per cent were unsuccessful; and
- the Withdrawal Tender Price per Unit was \$0.986.

30. Under the Withdrawal Tender, 55,566,392 units were redeemed for a total amount of approximately \$54,788,463. All valid tenders made at a discount of 15 per cent were redeemed in full (that is, no scale back was applied).

31. Of the Withdrawal Tender Price per unit of \$0.986, an amount of \$0.88 per unit was debited against issued capital and the balance of the Withdrawal Tender Price was debited against retained earnings. No franking credits were attached to the distribution.

32. All units redeemed under the Withdrawal Tender were cancelled by LCL.

33. LRF advised that at the time of the redemption of units under the Withdrawal Tender, the sum of the market values of LRF's assets that were taxable Australian real property did not exceed the sum of the market values of LRF's assets that were not taxable Australian real property.

## **Ruling**

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### **Dividend Component**

34. Participating unitholders are taken to have received a unit trust dividend paid out of profits of \$0.106 (Dividend Component) for each unit redeemed under the Withdrawal Tender for the Withdrawal Tender Price per unit of \$0.986.

35. The Dividend Component of \$0.106 for each unit redeemed under the Withdrawal Tender is included in the assessable income of participating unitholders under subsection 44(1) of the ITAA 1936 (as modified by subsections 102T(11), 102T(12) and 102T(14) of the ITAA 1936) in the income year in which the Withdrawal Tender was conducted.

## **Dividend withholding tax**

36. The Dividend Component of \$0.106 will attract dividend withholding tax under section 128B of the ITAA 1936 if the unitholder is a non-resident (other than where one of the exceptions within section 128B of the ITAA 1936 applies. In particular, where a non-resident is covered by subsection 128B(3E) of the ITAA 1936).

## **Capital gains tax (CGT) consequences**

37. CGT event C2 happened in relation to each unit redeemed under the Withdrawal Tender on 8 November 2010 being the date that each participating unitholder's tender was accepted (subsection 104-25(2)).

38. The Withdrawal Tender Price per unit of \$0.986 represents the capital proceeds for CGT purposes pursuant to section 116-20. A participating unitholder will make a capital gain on each unit redeemed under the Withdrawal Tender if the capital proceeds received in relation to the redemption of the unit exceed the cost base of that unit. Similarly, participating unitholders will make a capital loss if the capital proceeds are less than the reduced cost base of the unit.

39. Under section 118-20, any capital gain a participating unitholder makes will be reduced to the extent that the capital proceeds have otherwise been included in assessable income.

## *Foreign resident unitholders*

40. A foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event C2 happened in relation to the redemption of a unit under the Withdrawal Tender, disregards under subsection 855-10(1) any capital gain or capital loss made from the CGT event where the unit in LRF is not taxable Australian property as defined in section 855-15.

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**Commissioner of Taxation**

23 March 2011

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## Appendix 1 – Explanation

**❶** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### Public trading trust considerations

41. LRF is a public trading trust within the meaning of section 102R of the ITAA 1936. It has not made a choice, pursuant to sections 713-130 and 703-50 of the ITAA 1997, to be treated as the head company of a consolidated group and is therefore subject to the modified application of the Act as set out in Division 6C of Part III of the ITAA 1936.

42. Broadly speaking, the purpose of Division 6C of Part III of the ITAA 1936 is to equate the tax treatment of public trading trusts with companies in relation to specified provisions of the Act.

43. In the present case, the modifications provided for in subsections 102T(11), 102T(12), and 102T(14) of the ITAA 1936 will result in unit trust dividends paid out of profits by the trustee of a prescribed trust estate being included in a resident unitholder's assessable income under subsection 44(1) of the ITAA 1936. If paid to a non-resident unitholder, such dividends are assessable to the unitholder to the extent to which they are paid out of profits derived by the trustee from sources in Australia.

44. Furthermore, the modifications provided for in subsections 102T(11), 102T(12), and 102T(20) of the ITAA 1936 extend the provisions relating to the imposition and collection of withholding tax on dividends paid to non-resident shareholders to unit trust dividends paid to non-resident unitholders.

### Unit trust dividend

45. The term 'unit trust dividend' is defined in section 102M of the ITAA 1936. It includes any distribution made by the trustee of a prescribed trust estate, whether in money or property, to a unitholder. However, later paragraphs in that definition exclude certain amounts from being a unit trust dividend as defined.

46. Relevantly, paragraph (d) of the definition of unit trust dividend in section 102M of the ITAA 1936 specifically excludes:

money paid or credited, or property distributed, by the trustee of a prescribed trust estate in respect of the cancellation, extinguishment or redemption of a unit to the extent to which:

- (i) the money paid or credited or the property distributed represents money paid to, or property transferred to, the trustee for the purpose of the creation or issue of that unit; and



- (ii) the amount of the money paid or credited or the value of the property distributed, as the case may be, does not exceed the amount of the money paid to the trustee, or the value, at the time of transfer, of the property transferred to the trustee, for the purpose of the creation or issue of that unit.

47. The effect of paragraph (d) of the definition of unit trust dividend in section 102M of the ITAA 1936 is that money paid or credited by the trustee in respect of the redemption of a unit that represents money paid, or property transferred for the creation or issue of the relevant unit is excluded from the definition of a 'unit trust dividend' **except to the extent** that the amount so paid or credited exceeds the money paid or the value of property transferred to the trustee for the purpose of the creation or issue of that unit.

48. In the present case, LRF will make a distribution of \$0.986 (the Withdrawal Tender Price per unit) for each unit redeemed under the Withdrawal Tender. It will account for the Withdrawal Tender Price per unit by debiting \$0.88 per unit against issued capital and the balance of \$0.106 per unit against retained earnings. The \$0.88 per unit debited against issued capital corresponds to the average capital per unit of the fund.

49. Being an amount sourced from issued capital, \$0.88 of each Withdrawal Tender Price per unit represents money that was paid to the trustee for the purpose of the creation or issue of the unit redeemed, and is potentially excluded from the definition of 'unit trust dividend' in section 102M of the ITAA 1936 under subparagraph (d)(i) of that definition.

50. Given that the amount so excluded is limited to the money paid or the value of property transferred to the trustee for the purpose of the creation or issue of that unit, it follows that no less than \$0.106 of each Withdrawal Tender Price per unit is a 'unit trust dividend' as defined in section 102M of the ITAA 1936.

## **Assessability of the unit trust dividend**

51. By virtue of subsections 102T(11), 102T(12), and 102T(14) of the ITAA 1936, a unit trust dividend paid out of profits by the trustee of a prescribed trust estate is included in a resident unitholder's assessable income under subsection 44(1) of the ITAA 1936. If paid to a non-resident unitholder, such a dividend is assessable to the extent to which it is paid out of profits derived by the trustee from sources in Australia.

52. In the present case, participating unitholders will receive a unit trust dividend of at least \$0.106 for every unit redeemed under the Withdrawal Tender. Given that LRF will source only \$0.106 of each Redemption Payment per unit from retained earnings, it follows that only \$0.106 of the Withdrawal Tender Price per unit is a unit trust dividend paid out of profits. In this Ruling, this amount is referred to as the Dividend Component.

53. The Dividend Component of \$0.106 for each unit redeemed under the Withdrawal Tender is included in the assessable income of participating unitholders under subsection 44(1) of the ITAA 1936, as modified by subsections 102T(11), 102T(12), and 102T(14) of the ITAA 1936, in the income year in which the Withdrawal Tender was conducted.

### **Dividend withholding tax**

54. Section 128B of the ITAA 1936, as modified by subsections 102T(11), 102T(12) and 102T(20) of the ITAA 1936, ensures that unit trust dividends derived by a non-resident and paid by the trustee of a prescribed trust estate are subject to withholding tax in certain circumstances.

55. In the present case, participating non-resident unitholders will be subject to withholding tax on the full unfranked Dividend Component of \$0.106 unless one of the exceptions within section 128B of the ITAA 1936 applies.

56. In particular, subsection 128B(3E) of the ITAA 1936 will apply to exclude the Dividend Component from withholding tax where the dividend:

- is paid to a person who is a non-resident carrying on business in Australia at or through a permanent establishment of the person in Australia; and
- is attributable to the permanent establishment; and
- is not paid to the person in their capacity as trustee,

in which case the Dividend Component of \$0.106 will be assessable income of the non-resident unitholder under subsection 44(1) of the ITAA 1936.

57. Where the Dividend Component paid to a non-resident unitholder is subject to withholding tax, it will not be assessable income and will not be exempt income pursuant to section 128D of the ITAA 1936.

58. The withholding tax rate of 30 per cent will apply to the full unfranked Dividend Component of \$0.106. However, this rate is generally reduced to 15 per cent for countries which have a double tax agreement with Australia.

### **CGT consequences**

59. CGT event C2 happened in relation to each unit redeemed under the Withdrawal Tender on 8 November 2010 being the date that each participating unitholder's tender was accepted (subsection 104-25(2)).

60. The capital proceeds for CGT purposes in respect of each LRF unit redeemed under the Withdrawal Tender is \$0.986 pursuant to section 116-20. A participating unitholder will make a capital gain on each unit redeemed under the Withdrawal Tender if the capital proceeds exceed the cost base of that unit. Similarly, participating unitholders will make a capital loss if the capital proceeds are less than the reduced cost base of the unit (subsection 104-25(3)).

61. However, a participating unitholder will have the amount of the capital gain reduced under the anti overlap provisions contained in section 118-20 by the extent that the capital proceeds have otherwise been included in assessable income.

#### *Foreign resident unitholders*

62. Under subsection 855-10(1), an entity disregards a capital gain or capital loss made from a CGT event if they are a foreign resident, or the trustee of a foreign resident trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

63. The term 'taxable Australian property' is defined in the table in section 855-15. The table sets out these five categories of CGT assets:

- |        |   |
|--------|---|
| Item 1 | taxable Australian real property;   |
| Item 2 | an indirect Australian real property interest not covered by item 5;  |
| Item 3 | a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5; |
| Item 4 | an option or right to acquire a CGT asset covered by item 1, 2 or 3; and  |
| Item 5 | a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).              |

64. In the present case, LRF has advised that at the time of the redemption of units under the Withdrawal Tender, the units were not taxable Australian real property and not an indirect Australian real property interest (as defined in section 855-25) as the interest did not pass the principal asset test in section 855-30 at that time.

65. Consequently, a foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event C2 happened in relation to units redeemed under the Withdrawal Tender, cannot disregard under subsection 855-10(1) any capital gain or capital loss made if:

- (a) the unit in LRF has been used at any time by the foreign resident, or the trustee of a foreign resident trust for CGT purposes, in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15); or
- (b) the unit in LRF is covered by subsection 104-165(3) (item 5 of the table in section 855-15).

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

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

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## References

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### *Previous draft:*

Not previously issued as a draft

### *Related Rulings/Determinations:*

TR 2006/10

### *Subject references:*

- capital gains tax
- capital reductions
- dividend income
- non resident dividend withholding tax

### *Legislative references:*

- |                          |                        |
|--------------------------|------------------------|
| - ITAA 1936              | - ITAA 1936 102T(14)   |
| - ITAA 1936 6(1)         | - ITAA 1936 102T(20)   |
| - ITAA 1936 44(1)        | - ITAA 1936 128B       |
| - ITAA 1936 Pt III Div 6 | - ITAA 1936 128B(3E)   |
| - ITAA 1936 102M         | - ITAA 1936 128D       |
| - ITAA 1936 102R         | - ITAA 1997            |
| - ITAA 1936 102T         | - ITAA 1997 104-25     |
| - ITAA 1936 102T(11)     | - ITAA 1997 104-25(2)  |
| - ITAA 1936 102T(12)     | - ITAA 1997 104-25(3)  |
|                          | - ITAA 1997 104-165(3) |
|                          | - ITAA 1997 116-20     |
|                          | - ITAA 1997 118-20     |
|                          | - ITAA 1997 118-25     |
|                          | - ITAA 1997 Div 230    |
|                          | - ITAA 1997 703-50     |
|                          | - ITAA 1997 713-130    |
|                          | - ITAA 1997 855-10     |
|                          | - ITAA 1936 855-10(1)  |
|                          | - ITAA 1997 855-15     |
|                          | - ITAA 1997 855-25     |
|                          | - ITAA 1997 855-30     |
|                          | - TAA 1953             |
|                          | - Copyright Act 1968   |

### ATO references

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 Income Tax ~~ Assessable income ~~ dividend, interest and royalty income  
 Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 – end of a CGT asset