

CR 2013/21 - Income tax: return of capital: Residential - Plus Growth Company Ltd

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Class Ruling

Income tax: return of capital: Residential – Plus Growth Company Ltd

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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:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- subsection 6(4) of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- section 995-1 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies are the Australian resident ordinary shareholders of Residential – Plus Growth Company Ltd (RPGCL) who:

- (a) are shareholders of RPGCL on the record dates, being the dates for determining entitlement to the return of capital payments, and who continue to hold the ordinary shares at the dates the return of capital payments are made;
- (b) hold their RPGCL shares neither as 'revenue assets' (as defined in section 977-50 of the ITAA 1997) nor as 'trading stock' (as defined in subsection 995-1(1) of the ITAA 1997) – that is, broadly on capital account; and
- (c) 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 RPGCL shares.

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

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement 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 23 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 from 1 July 2011 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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 a number of documents provided to the Commissioner. These documents or relevant parts of them, as the case may be, form part of and are to be read with this description. The documents include:

- the request for a Class Ruling from RPGCL dated 19 September 2012;
- RPGCL's prospectus (the Prospectus) dated 28 March 2002;
- RPGCL's audited financial report for the year ended 30 June 2011;
- Epping Rail Link Residential Property Trust's audited financial report for the year ended 30 June 2011; and
- Investment updates on RPGCL.

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. RPGCL is an unlisted public company incorporated and domiciled in Australia.

11. RPGCL was established in 2002 to invest indirectly (through other investment vehicles) in Australian residential and commercial properties that were expected to benefit from major urban development projects/plans.

12. The Prospectus specified that these investments would be long, fixed term, illiquid and relatively high risk. In addition the Prospectus stated the following with respect to the life of the company:

- The Company's life is a minimum of 7 years (or less if all underlying investments are realised) and is anticipated to be a maximum of 10 years.

- The Company will realise investments when it considers it appropriate and is able to do so. The realisation of investments is expected to take between 5 and 8 years from initial acquisition.
- It is anticipated that the Company will be wound up when all investments are realised and distributions made.

13. RPGCL invested in two property trusts. The objective of these property trusts was to target re-zoning opportunities that arose from major urban development projects. The end date for these property trusts was December 2012. The two property trusts have commenced the progressive disposal of their property investments and realisation of any gains or losses, resulting in the availability of funds for RPGCL to return to shareholders.

14. To allow for the orderly sell down of the properties yet to be disposed of and additional time for re-zoning decisions to be made on some of these remaining properties, the unit holders of these two property trusts agreed to extend the end dates for the property trusts. The end date for one of the property trusts was extended to December 2013 and the end date for the other was extended to December 2014.

15. Since inception to the year ended 30 June 2011, RPGCL has incurred total tax losses of \$3,565,177 and total net accounting losses before tax amounting to \$4,686,869.

16. During the year ended 30 June 2011, RPGCL received a distribution from one of the property trusts it invested in, as a result of the property trust commencing the disposal of all properties. This has resulted in an accounting profit for the year ended 30 June 2011; however, the company is still in an accumulated loss position. As the distribution received was tax deferred and accordingly not included as assessable income in the year ended 30 June 2011, the company is in a taxable loss position for that income year, increasing its carried forward tax losses.

17. The Board of Directors of RPGCL (the Board) has determined that there is no reason to retain capital given the company is due to wind up following the realisation of its investments, and anticipates that overall (from inception to winding up) a financial loss will be made on the investments made. Accordingly, the Board decided that the funds from the distribution the company received from its underlying investment were to be paid out as returns of capital rather than dividends.

18. The Board approved the following distributions to RPGCL shareholders:

- Distribution of 6.68 cents per share, paid in October 2011.
- Distribution of 5.81 cents per share, paid in May 2012.

19. Shareholder approval has been received to treat these distributions as returns of capital.
20. There will be no change in either the number of RPGCL shares on issue held by each RPGCL shareholder or the proportionate interest of each shareholder in RPGCL.
21. Both distributions were debited to the share capital account. The share capital account is not tainted (within the meaning of Division 197 of the ITAA 1997).
22. Apart from these two distributions, no dividend or other distribution has been declared or paid since the inception of the company.
23. It is expected that future distributions by RPGCL will also be treated in the same way as these two distributions. That is, they will be funded by the realisation of RPGCL's investments, they will have shareholder approval to be treated as returns of capital, they will be provided to shareholders in the same proportion as their shareholding and they will be debited to the share capital account.

Ruling

Distributions are not dividends

24. The returns of capital are not dividends, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C

25. Subject to paragraph 26 of this Ruling the Commissioner will not make a determination under either subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole or any part of the returns of capital.
26. If RPGCL's financial position changes such that it is no longer expected that RPGCL will make an overall (from inception to winding up) financial loss or if the actual circumstances of future distributions are not as set out in paragraph 23 above, the application of sections 45A and 45B will need to be re-examined.

Capital gains tax

27. CGT event G1 (section 104-135 of the ITAA 1997) happens when RPGCL pays the returns of capital to a shareholder.

Commissioner of Taxation

27 March 2013

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.***

28. Subsection 44(1) includes in a shareholder’s assessable income any dividends, as defined in subsection 6(1), paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

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

30. ‘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 after 1 July 1998 where the first amount credited to the account was an amount of share capital.

31. Subsection 975-300(3) of the ITAA 1997 states that an account is generally taken not to be a share capital account if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the account and the account is not already tainted.

32. The returns of capital are debited to RPGCL’s untainted share capital account.

33. Therefore, paragraph (d) of the definition of ‘dividend’ in subsection 6(1) applies and the returns of capital are not dividends.

Anti-avoidance provisions

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

Section 45A – streaming of dividends and capital benefits

35. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who would derive a greater benefit from the receipt of capital benefits than other shareholders, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received, or will receive, dividends.

36. By making the returns of capital, RPGCL provides its shareholders with 'capital benefits', as defined in paragraph 45A(3)(b), and the capital benefits are provided to all RPGCL shareholders in the same proportion as their individual share holding. As all shareholders benefit equally from the returns of capital, there is no 'streaming' of capital benefits to some shareholders and not to others.

37. Accordingly, section 45A will not apply to the returns of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the whole or any part of the return of capital amounts.

Section 45B – schemes to provide capital benefits

38. Section 45B applies where certain capital payments, including a return of capital, are made to shareholders in substitution for dividends. Specifically, the provision applies where:

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

Each of these conditions is considered in paragraphs 39 to 54 of this Ruling.

Scheme

39. 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.

40. 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.

41. As the returns of capital are debited to RPGCL's share capital account, they provide shareholders with a capital benefit under paragraph 45B(5)(b).

Tax benefit

42. A relevant taxpayer 'obtains a tax benefit', as defined in subsection 45B(9), 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, be less than the amount that:
- would have been payable; or
- be payable at a later time than it would have been payable, if the capital benefit instead had been a dividend.

43. The distributions to RPGCL's ordinary shareholders are returns of capital and, therefore, constitute capital benefits. In the event that the relevant distributions were dividends rather than capital benefits, it is likely that the amount of tax payable by RPGCL's shareholders would be greater than is payable in respect of the return of capital payments (those payments being the capital benefits). Consequently, the receipts of the capital benefits are 'tax benefits'.

44. Ordinarily, a return of capital would be subject to the CGT provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the shares, 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 shares that a capital gain arises. By contrast, a dividend would generally be included in the assessable income of a resident shareholder. Therefore, resident shareholders of RPGCL will obtain tax benefits from the returns of capital.

Relevant circumstances

45. Paragraph 45B(2)(c) requires the Commissioner to consider the 'relevant circumstances' of the scheme as set out in subsection 45B(8). Considering these circumstances determines whether any part of the scheme is entered into for a purpose, other than an incidental purpose, of enabling the relevant taxpayer (that is, an Australian resident ordinary shareholder in RPGCL) to obtain a tax benefit.

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

47. The purpose which causes section 45B to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is concerned only with the purpose of RPGCL. The Commissioner cannot ascertain the purposes of RPGCL's numerous shareholders, all of whom are eligible to vote on the return of capital under section 256C of the *Corporations Act 2001*, and all of whom participate in the return of capital. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company should, generally speaking, not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who vote in favour of the payment.

48. The relevant circumstances under subsection 45B(8) cover the circumstances of the company and the tax profile of the shareholders. In this instance, because the return of capital is to be made to all RPGCL shareholders, regardless of individual circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(i) and (j), pertaining to the provision of ownership interests and demerger respectively, are not relevant. The relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

49. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised or unrealised) of the company or an associate (within the meaning of section 318) of the company.

50. In relation to this attribution question, the following is considered relevant:

- RPGCL is nearing the end of its life with the two property trusts it has invested in having end dates of December 2013 and December 2014.
- The two property trusts have now commenced the progressive disposal of their long term property investments.
- The Board has determined there is no reason to retain capital given RPGCL is due to wind up following the realisation of its investments.
- The returns of capital by RPGCL result from distribution receipts from its underlying investments after the disposal of their property investments.

- RPGCL has substantial accumulated accounting and tax losses even after receipt of the distribution from its underlying investments.
- The Board expects that overall (from inception to winding up) RPGCL will make a financial loss.

Having regard to all of the above, it is not considered that the returns of capital by RPGCL are attributable to profits; rather they are considered to be attributable to capital only.

51. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate (within the meaning of section 318) of the company. RPGCL has no prior history of making distributions as it has always been in a loss situation. It is considered that in this case, this criteria neither inclines for or against a purpose of enabling a taxpayer to obtain a tax benefit.

52. 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 the financial and other implications for the parties involved.

53. In this case, the practical implications of the scheme for RPGCL and its shareholders are consistent with it being, in form and in substance, a distribution of capital.

54. It cannot be concluded that RPGCL or RPGCL's shareholders entered into the scheme for the purpose of enabling the shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole or any part of the returns of capital.

Section 45C

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

CGT event G1 – section 104-135

56. CGT event G1 (section 104-135 of the ITAA 1997) happens each time RPGCL pays one of the returns of capital to a RPGCL shareholder.

57. If the return of capital payment is less than or equal to the cost base of the RPGCL share at the time of the payment, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the return of capital payment (subsection 104-135(4) of the ITAA 1997).

58. A RPGCL shareholder makes a capital gain if the return of capital payment is more than the cost base of the RPGCL share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

59. If a RPGCL shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the share are subsequently reduced to nil (subsection 104-135(3) of the ITAA 1997). A RPGCL shareholder cannot make a capital loss when CGT event G1 happens.

60. If the RPGCL share to which the payment relates was acquired by a RPGCL shareholder at least 12 months before the payment of the return of capital, a capital gain made when CGT event G1 happens will 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

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

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References

<i>Previous draft:</i>	- ITAA 1936 45B(8)(g)
Not previously issued as a draft	- ITAA 1936 45B(8)(h)
	- ITAA 1936 45B(8)(i)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(8)(j)
TR 2006/10	- ITAA 1936 45B(8)(k)
	- ITAA 1936 45B(9)
	- ITAA 1936 45C
<i>Subject references:</i>	- ITAA 1936 177A(1)
- capital gains tax	- ITAA 1936 177D(b)(i)
- dividends	- ITAA 1936 177D(b)(ii)
- return of capital on shares	- ITAA 1936 177D(b)(iii)
	- ITAA 1936 177D(b)(iv)
<i>Legislative references:</i>	- ITAA 1936 177D(b)(v)
- ITAA 1936	- ITAA 1936 177D(b)(vi)
- ITAA 1936 6(1)	- ITAA 1936 177D(b)(vii)
- ITAA 1936 6(4)	- ITAA 1936 177D(b)(viii)
- ITAA 1936 44(1)	- ITAA 1936 318
- ITAA 1936 45A	- ITAA 1997
- ITAA 1936 45A(2)	- ITAA 1997 104-135
- ITAA 1936 45A(3)(b)	- ITAA 1997 104-135(3)
- ITAA 1936 45B	- ITAA 1997 104-135(4)
- ITAA 1936 45B(2)(a)	- ITAA 1997 Subdiv 115-A
- ITAA 1936 45B(2)(b)	- ITAA 1997 115-25(1)
- ITAA 1936 45B(2)(c)	- ITAA 1997 Div 197
- ITAA 1936 45B(3)	- ITAA 1997 197-50
- ITAA 1936 45B(5)	- ITAA 1997 Div 230
- ITAA 1936 45B(5)(b)	- ITAA 1997 975-300
- ITAA 1936 45B(8)	- ITAA 1997 975-300(3)
- ITAA 1936 45B(8)(a)	- ITAA 1997 977-50
- ITAA 1936 45B(8)(b)	- ITAA 1997 995-1
- ITAA 1936 45B(8)(c)	- ITAA 1997 995-1(1)
- ITAA 1936 45B(8)(d)	- Copyright Act 1968
- ITAA 1936 45B(8)(e)	- Corporations Act 2001 256C
- ITAA 1936 45B(8)(f)	

ATO references

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