


CR 2015/42 - Income tax: returns of capital: IPE Limited

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Class Ruling

Income tax: returns of capital: IPE Limited

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① 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 provisions

2. The relevant provisions 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
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-135 of the ITAA 1997
- Division 115 of the ITAA 1997, and
- section 855-10 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 is the holders of ordinary shares in IPE Limited (IPE) who:

- (a) were listed on the IPE share register on the relevant date (Record Date) for determining an entitlement to receive a return of capital made on 16 September 2014 and/or 14 April 2015
- (b) did not hold their IPE shares 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, they held their IPE shares broadly on capital account, and
- (c) were not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their IPE 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, a person belonging to this class of entities is referred to as an 'IPE shareholder'.

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 8 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

7. This Ruling applies from 1 July 2014 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

8. 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:

- the Class Ruling application dated 20 April 2015 and documents attached and referred to in the Class Ruling application, including the following:
 - Annexure A – Class Ruling CR 2014/50
 - Annexure B – Shareholder Update released 22 October 2008
 - Annexure C – Interim Report of IPE for the half year ended 31 December 2014
 - Annexure D – Extract from Notice of AGM held on 29 October 2014 and Results, and
- additional information from the applicant dated 8 May 2015.

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

9. IPE is an Australian resident company which has been listed on the Australian Securities Exchange (ASX) since November 2004.

10. IPE's principal activity is investing in private equity funds.

11. In October 2008 and June 2009, the Board of Directors announced that IPE would cease making new investments and would instead be progressively wound up.

Investing in private equity funds

12. IPE keeps accounts and portfolio records of investments it makes in private equity funds such that it is able to identify all of its receipts from these investments as one of the following:

- a return of capital invested;
- a capital gain on capital invested, or
- income generated by capital invested.

Status of the IPE portfolio – capital now excess to requirements

13. In recent years, IPE had been able to pay dividends to its shareholders purely out of profits (being income and capital gains arising from its investments in private equity funds). IPE had used only the capital returns from the private equity funds to make further investments in other private equity funds to satisfy its commitments.

14. The position changed in 2014 because IPE's undrawn commitment amounts reached a low level. IPE wants to continue to deliver cash back to its shareholders. Part of that cash will now have the character of capital, in the sense that it flows from returns of share capital invested in private equity funds, arising from the disposal of assets by those funds. In addition, IPE has received cash from a number of funds as a result of companies which were the underlying investments of those funds re-financing themselves. In many of those instances the cash-flows to IPE were identified as returns of capital, and according to the fund manager, represented returns of share capital from underlying companies that the private equity funds had invested in.

Returns of capital

15. IPE paid returns of capital of 3.5 cents per share on 16 September 2014 and 1.75 cents per share on 14 April 2015. These returns of capital were approved by IPE shareholders and were paid equally to each shareholder listed on IPE's share register on the Record Date for each of these returns of capital.

16. The Record Date of each return of capital and the date when each return of capital was paid by IPE (Payment Date) all occurred during the year ending 30 June 2015.

17. IPE debited the entire amount of each return of capital against the company's share capital account. There was no change in either the number of IPE shares on issue or the proportionate interest of each shareholder in IPE.

18. The returns of capital were sourced from IPE's existing net cash reserves.

Other matters

19. The IPE Interim Report for the half year ended 31 December 2014 disclosed:

- a net profit after tax of \$579,000
- \$62,762,122 in its share capital account as at 31 December 2014
- accumulated losses of \$13,147,190, and
- total equity of \$49,614,932.

20. IPE consistently paid dividends in its early years, but the last dividend paid before the global financial crisis was in September 2008. IPE then retained its receipts to ensure that it would have sufficient cash to satisfy any of its investment commitments when called on, but was able to start paying dividends again in 2012. The table below shows the dividend history since the resumption in 2012:

| <u>Payment date</u> | <u>Cents per share</u> | <u>Franked</u> | <u>Total</u> |
|---------------------|------------------------|----------------|--------------|
| 28 June 2012 | 2.50 | 100% | \$3.41m |
| 9 November 2012 | 2.25 | 100% | \$3.07m |
| 19 July 2013 | 3.50 | 100% | \$4.78m |
| 5 December 2013 | 3.00 | 100% | \$4.10m |
| 4 December 2014 | 3.00 | 100% | \$4.10m |
| 14 April 2015 | 1.75 | 0% | \$2.39m |

The dividend paid on 14 April 2015 was not franked due to an insufficient franking balance.

21. The returns of capital do not reflect any change in the dividend policy of IPE.

22. On the Payment Date of each return of capital IPE had 136,571,202 ordinary shares on issue.

23. Prior to the above returns of capital IPE had only paid a return of capital of 4 cents per share on 18 July 2014 (the subject of CR 2014/50) and had not undertaken any share buy-backs since listing on the ASX.

24. As at the end of March 2015, IPE had 2,048 shareholders on its share register. The top 20 shareholders held 61.78% of the issued shares.

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

Ruling

Returns of capital not dividends

26. The returns of capital paid to IPE shareholders are not dividends as defined in subsection 6(1).

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

27. The Commissioner will not make a determination under section 45A or section 45B that section 45C applies in relation to the returns of capital received by IPE shareholders.

Capital gains tax (CGT) consequences

28. CGT event G1 (section 104-135 of the ITAA 1997) happened when IPE paid each return of capital to an IPE shareholder in respect of an IPE share that they owned at the relevant Record Date and continued to own at the relevant Payment Date.

29. CGT event C2 (section 104-25 of the ITAA 1997) happened when IPE paid each return of capital to an IPE shareholder in respect of an IPE share that they owned at the relevant Record Date, but ceased to own before the relevant Payment Date.

Foreign resident shareholders

30. An IPE shareholder who was a foreign resident just before CGT event G1 happened disregards any capital gain made when CGT event G1 happened if their IPE shares were not 'taxable Australian property' (section 855-10 of the ITAA 1997).

31. An IPE shareholder who was a foreign resident just before CGT event C2 happened disregards any capital gain or capital loss made when CGT event C2 happened if their right to receive each return of capital was not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

24 June 2015

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.*

Returns of capital not dividends

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

33. 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.

34. Subsection 975-300(3) of the ITAA 1997 provides that an account is generally taken not to be a share capital account if it is tainted. IPE has confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997.

35. Each return of capital was recorded as a debit to IPE's share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) applies and neither return of capital is a dividend as defined in subsection 6(1).

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

36. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of each return of capital received by IPE shareholders as an unfranked dividend paid by the company out of profits.

Section 45A – streaming of dividends and capital benefits

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

38. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) to include the distribution to the shareholder of share capital. IPE provided its shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b) when IPE paid each return of capital.

39. Each capital benefit was provided to all shareholders in the same proportion as their share holdings.

40. Accordingly, section 45A does not apply to the returns of capital and 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 returns of capital.

Section 45B – scheme to provide capital benefits

41. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, subsection 45B(2) applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a)), and
- (b) 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
- (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 (the **relevant taxpayer**) to obtain a tax benefit (paragraph 45B(2)(c)).

42. Each return of capital satisfies the conditions in paragraphs 45B(2)(a) and 45B(2)(b). However, having regard to the relevant circumstances of each scheme (comprising each return of capital paid), it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling IPE shareholders to obtain a tax benefit.

43. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or a part, of the payments of the returns of capital.

CGT consequences

CGT event G1 – section 104-135 of the ITAA 1997

44. CGT event G1 happened when IPE made each return of capital to an IPE shareholder in respect of a share that the shareholder owned at the relevant Record Date and continued to own at the relevant Payment Date (section 104-135 of the ITAA 1997).

45. An IPE shareholder made a capital gain if each return of capital was more than the cost base of the shareholder's IPE share. The amount of the capital gain was equal to the excess (subsection 104-135(3) of the ITAA 1997).

46. If an IPE shareholder made a capital gain when CGT event G1 happened, the cost base and reduced cost base of the IPE share are reduced to nil. An IPE shareholder cannot have made a capital loss when CGT event G1 happened (Note 1 to subsection 104-135(3) of the ITAA 1997).

47. If each return of capital, of 3.5 cents per share and 1.75 cents per share respectively, was equal to or less than the cost base of the IPE share at the time of payment, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

48. A capital gain made when CGT event G1 happened is eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided that the IPE shareholder acquired the IPE share at least 12 months before the payment of the return of capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of Division 115 are satisfied.

49. An IPE shareholder who was a foreign resident or temporary resident must meet further conditions to be eligible to treat the capital gain as a discount capital gain under Division 115 of the ITAA 1997.

CGT event C2 – section 104-25 of the ITAA 1997

50. CGT event C2 happened when each return of capital was paid to an IPE shareholder that held the share at the Record Date but no longer owned the share at the Payment Date (section 104-25 of the ITAA 1997).

51. The right to receive each return of capital was one of the rights inherent in an IPE share held at the Record Date. If, after the Record Date but before the Payment Date, an IPE shareholder ceased to own an IPE share in respect of which each return of capital was payable, then the right to receive the return of capital was retained by that shareholder and constituted a separate CGT asset.

52. The right to receive each return of capital was ended by the right being discharged or satisfied when the payment was made.

53. An IPE shareholder made a capital gain if the capital proceeds from the ending of the right was more than the cost base of the right. The capital gain is equal to the amount of the excess. An IPE shareholder made a capital loss if the capital proceeds from the ending of the right was less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3) of the ITAA 1997).

54. In working out the capital gain or capital loss made when CGT event C2 happened, the capital proceeds was the amount of each return of capital paid (3.5 cents per share and 1.75 cents per share respectively) (subsection 116-20(1) of the ITAA 1997).

55. The cost base of the IPE shareholder's right to receive each return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by an IPE shareholder that was applied in working out a capital gain or capital loss made when a CGT event happened to the share, for example, when the IPE shareholder disposed of the share after the relevant Record Date.

56. Therefore, if the entire cost base or reduced cost base of the IPE share was applied in working out a capital gain or capital loss when a CGT event happened to that share, then the right to receive each return of capital was likely to have a cost base of nil. Therefore, the IPE shareholder generally made a capital gain equal to the amount of each return of capital of 3.5 cents per share and 1.75 cents per share respectively.

57. As the right to receive the payment of each return of capital was inherent in the IPE share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997).

58. Accordingly, if the IPE share was acquired at least 12 months before the payment of each return of capital, a capital gain made from the ending of the corresponding right satisfies the requirements of section 115-25 of the ITAA 1997. The capital gain may be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided the other conditions of Division 115 of the ITAA 1997 are satisfied.

59. An IPE shareholder who was a foreign resident or temporary resident must meet further conditions to be eligible to treat any capital gain as a discount capital gain under Division 115 of the ITAA 1997.

Foreign resident shareholders

60. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss made from a CGT event if:

- just before the CGT event happened, the entity is a foreign resident, or the trustee of a foreign trust for CGT purposes, and
- the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

61. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out 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). |

62. An IPE shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event G1 happened to their IPE share under subsection 855-10(1) if:

- (a) their IPE share was an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997); or
- (b) their IPE share had been used at any time by them in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- (c) their IPE share was covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

63. An IPE shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event C2 happened to their right to receive a return of capital if:

- (a) the right had been used at any time by them in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997), or
- (b) the right was covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; CR 2014/50

Subject references:

- capital benefit
- capital gains tax
- capital reductions
- CGT event C1-C3 – end of a CGT asset
- CGT event G1-G3 – shares
- return of capital on shares
- share capital
- shareholder payments

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45C
- ITAA 1997
- 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 104-165(3)
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Div 115
- ITAA 1997 115-25
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-10
- ITAA 1997 855-10(1)
- ITAA 1997 855-15
- ITAA 1997 975-300
- ITAA 1997 977-50
- ITAA 1997 995-1
- TAA 1953

ATO references

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Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events G1 to G3 - shares

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