


# ***CR 2015/56 - Income tax: Asset Resolution Limited - Return of Share Capital***

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## Class Ruling

# Income tax: Asset Resolution Limited – Return of Share Capital

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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 provisions 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 44 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
- section 855-10 of the ITAA 1997, and
- Section 855-25 of the ITAA 1997.

All 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 shareholders of Asset Resolution Limited (**ARL**) who:
- (a) are registered on the ARL share register as at 11:00am on 22 June 2015 (Record Date), being the date for determining entitlement on 13 July 2015 (Implementation Date) to the return of capital payment (return of capital) by ARL
  - (b) hold their ARL shares 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 ARL 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 'ARL 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 9 to 30 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

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7. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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).

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## Previous Rulings

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8. Class Ruling CR 2014/108 Income tax: Asset Resolution Limited – Return of Share Capital.

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## Scheme

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9. 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.

10. ARL is an unlisted, special purpose turnaround and recovery vehicle company. Its principal activities are holding; improving; and realising various assets securing mortgage loans. Each of the Company's mortgage loans have been in default prior to their assignment to the Company.

11. On 4 September 2012, ARL issued 830,532,768 shares to Wellington Capital Limited as responsible entity for the Premium Income Fund (PI Fund) in exchange for receiving various assets.

12. The assets included a number of mortgages and debts owed on various real properties or ventures, and rights in respect of certain legal proceedings.

13. The assets were transferred to ARL at market value on 4 September 2012 of \$50,465,000.

14. The PI Fund made an in specie distribution of the 830,532,768 shares to unitholders in the PI Fund on 5 September 2012.

15. On 19 December 2012, ARL issued 150,025,399 shares (the 'additional shares') to Perpetual Nominees Ltd (PNL) as custodian for the PI Fund in exchange for receiving various additional assets.

16. The additional assets included facilities and securities relating to the Forest Resort Hotel. These assets were transferred to ARL at market value on 19 December 2012 of \$4,940,000.

17. PNL subsequently sold the additional shares in January 2015.

18. The PI Fund disclosed in its *2014 Annual Report* that the market value amounts for the transfer of both the assets and the additional assets were recorded as a reduction to the Contributed Equity of the PI Fund in the year ended 30 June 2013.

19. The PI Fund was originally called the MFS Premium Income Fund. The PI Fund is a managed investment scheme that was established in 1999. Units in the PI Fund are traded on the National Stock Exchange of Australia (NSX) under the ticker PIN.

20. The *in specie* distribution of ARL shares to unitholders was subject to litigation under specific provisions of Australian corporations legislation. On 5 November 2014, the High Court of Australia made orders in *Wellington Capital Limited v. Australian Securities and Investment Commission* [2014] HCA 43 such that the declarations of the Full Court of the Federal Court of Australia stand. Those declarations have the effect for present purposes that the *in specie* distribution of the 830,532,768 shares to unitholders in the PI Fund on 5 September 2012 remains in place. Further, the decision of the High Court of Australia does not impugn the validity of the transfer of legal title in the shares in ARL to unitholders in the PI Fund.

21. In its *Interim Financial Report for the half year ended 31 December 2014*, ARL disclosed:

- Contributed equity of \$45,599,418 and Accumulated losses of \$26,081,454
- a gain on realising mortgage loans of \$444,155
- operating costs of \$1,090,071
- impairment loss on mortgage loans of \$1,061,914
- proceeds and vendor finance from the disposal of the Kooralbyn Resort
- the sale of the sole remaining unit in the Outrigger Resort, and
- a trading surplus of less than \$600,000 from operating some of the properties.

22. At Notes 1(b) and 1(e) to its *Interim Financial Report for half year ended 31 December 2014*, ARL also disclosed that:

...

The net gain or loss on disposal or settlement of an asset, other than mortgage loan security assets, is included as either a revenue or an expense at the date control of the asset passes to the buyer, usually when an unconditional contract of sale is signed, or when final settlement of the loan is achieved.

The gain or loss on disposal is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal (including incidental costs).

...

Receipts collected and payments made in relation to the management of the asset held as underlying security for the mortgage loans, have been included in the mortgage loan's carrying value calculation. The carrying value of the loan is then subject to impairment considerations as noted.

23. When ARL completes the recovery and turnaround of its loan assets including sales of underlying securities (being real properties), it will cease to trade.

24. On 11 December 2014, ARL made a return of capital to shareholders of \$0.01 per share. ARL's share capital reduced by \$9,805,582 as disclosed at 31 December 2014. ARL has not made any dividend or other distributions to its shareholders.
25. At the Extraordinary General Meeting held on 22 June 2015, ARL shareholders approved a resolution to make a return of capital of 1 cent per ARL share to ARL shareholders at the Record Date as at 11:00am on that day.
26. Subsequently, ARL announced on 2 July 2015:
- At the EGM on 22 June 2015, the resolution for the distribution to be a return of capital was passed. The distribution is currently scheduled for 13 July 2015.
- The ARL Board was notified on 22 June 2015 that the Liquidators of Octaviar Administration are deferring the distribution of the intended fifth dividend (after issuing notice to ARL of intention to declare the dividend). Whilst the ARL Board has sufficient cash to make the \$0.01 return of capital, it has been decided by the ARL Board that in light of this change in circumstances it is prudent that the Board reduces the return of capital to \$0.009 per share in order to fund the ongoing operations of ARL until this dividend is received.
27. ARL shareholders received a return of capital of 0.9 cents per share on the Implementation Date, 13 July 2015, a total amount of \$8,825,026.12.
28. When the return of capital was made on 13 July 2015, ARL's accumulated losses had not reduced from the amount disclosed as at 31 December 2014. At the time the return of capital, ARL did not have any retained profits in its accounts.
29. Foreign residents hold less than 2% of ARL shares on issue.
30. ARL's share capital account (as defined in section 975-300 of the ITAA 1997) is not tainted within the meaning of Division 197 of the ITAA 1997.

## **Ruling**

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### **Return of capital not a dividend**

31. The return of capital paid to ARL shareholders will not be a dividend as defined in subsection 6(1).

### **The application of sections 45B and 45C**

32. The Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole or any part of the return of capital received by ARL shareholders.

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

33. CGT event G1 (section 104-135 of the ITAA 1997) happened when ARL paid the return of capital to an ARL shareholder in respect of a share owned by the shareholder at the Record Date which the shareholder continued to own on the Implementation Date.

34. CGT event C2 (section 104-25 of the ITAA 1997) happened when ARL paid the return of capital to an ARL shareholder that owned a share at the Record Date, but no longer owned at the Implementation Date.

## **Foreign resident shareholders**

35. A foreign resident ARL shareholder who received the return of capital may disregard any capital gain made when CGT event G1 happened if their ARL share did not constitute 'taxable Australian property' (section 855-10 of the ITAA 1997).

36. A foreign resident ARL shareholder who received the return of capital may disregard any capital gain or capital loss made when CGT event C2 happened if the right to receive the payment was not 'taxable Australian property' (section 855-10 of the ITAA 1997).

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**Commissioner of Taxation**

29 July 2015

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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.*

### **Return of capital not a dividend**

37. 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.

38. 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.

39. 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. ARL has confirmed that its share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

40. The return of capital was recorded as a debit to ARL's share capital account. As the share capital account of ARL was not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies. Accordingly, the return of capital was not a dividend as defined in subsection 6(1).

### **Section 45B – scheme to provide capital benefits**

41. Section 45B applies where certain capital benefits, including a return of share capital, are provided to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to the whole or part of a capital benefit. Should section 45C apply, the capital benefit or the relevant part is taken to be a dividend. 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)].

42. Each of these conditions is considered in paragraphs 43 to 68 of this Explanation.

## ***Schemes to provide capital benefits***

43. The arrangement involving the return of capital to ARL shareholders will constitute a scheme for the purposes of section 45B.

44. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) and includes a distribution to the person of share capital. As the return of capital was debited to ARL's share capital account, ARL provided each shareholder with a capital benefit under paragraph 45B(5)(b) in the form of a distribution of share capital.

## ***Tax benefit***

45. The meaning of 'obtains a tax benefit' is defined in subsection 45B(9) as occurring where the amount of tax or other amount payable from the treatment of a return of capital distribution as a capital benefit would, apart from the operation of section 45B, be less than the amount that would be payable if the distribution had instead been a dividend.

46. As a return of capital will generally result in a lesser amount of tax payable than a dividend, ARL shareholders will obtain a tax benefit.

## ***Relevant circumstances***

47. Subsection 45B(8) sets out a list of factors for consideration for the 'relevant circumstances of the scheme' in determining whether, in relation to the scheme, any person has more than an incidental purpose of enabling a taxpayer to obtain a tax benefit. The relevant factors are considered in turn below.

### *Attribution*

48. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital or to profits of ARL.

49. Where a capital distribution is attributable to the disposal of business assets, a reasonable approach should be taken in determining the extent to which share capital was invested in the disposed assets and is available to be distributed to shareholders.

50. In the current circumstances, ARL is a specialist recovery and turnaround vehicle which has generated cash flow from the realisation of the underlying securities (or real properties) for mortgage loan assets as well as the proceeds from certain legal proceedings. The cash flows were generated where the mortgage loans were significantly impaired or realised at a loss, and a modest gain on some mortgage loans was offset by operating costs. The return of capital payment was sourced from the ARL's recent cash flows, in particular from the sales of the Kooralbyn Resort and the Outrigger Resort, and other trading assets.

51. ARL's *Interim Financial Report for the half year ended 31 December 2014* disclosed that the company incurred a loss before tax and also disclosed no retained earnings.

52. When the return of capital payment was made on 13 July 2015, ARL's accumulated losses had not reduced.

53. The above matters suggest this circumstance inclines moderately towards the conclusion as to requisite purpose.

#### *Distribution culture*

54. Paragraph 45B(8)(b) requires consideration of the pattern of distributions of dividends and returns of capital by ARL.

55. ARL paid a return of capital to shareholders on 11 December 2014. ARL has not made any dividend or other distributions to shareholders. At the time of that return of capital, ARL did not have any retained profits.

56. ARL did not have retained profits as at 31 December 2014 or at 13 July 2015 when the return of capital was paid.

57. ARL's circumstances suggest that this circumstance does not incline towards the conclusion as to requisite purpose.

#### *Residency of the shareholders*

58. Paragraph 45B(8)(e) requires consideration of whether the shareholders of ARL are non-residents.

59. As less than 2% of shares in ARL are held by non-residents, this circumstance does not incline towards the conclusion as to requisite purpose.

#### *Cost base of the shares*

60. Paragraph 45B(8)(f) requires consideration of whether the cost base of the ARL shares is not substantially less than the capital benefit of the return of capital of 0.9 cents per ARL share.

61. Based on the market values of the assets transferred to ARL when shares were issued to the PI Fund and those shares subsequently distributed in specie to unitholders in the PI Fund and to PNL as custodian for the PI Fund, and the somewhat limited trading in ARL shares, the cost base of each ARL share will most likely exceed the return of capital of 0.9 cents. That is, the cost base of each ARL share was not substantially less than the return of capital of 0.9 cents per ARL share.

62. This circumstance inclines moderately towards the conclusion as to requisite purpose.

## *Nature of interest after the return of capital*

63. Paragraph 45B(8)(h) requires consideration of whether the capital benefit was provided to a shareholder in circumstances where the shareholder's interest in the company was affected. If the shareholder continues to own the same number of shares and retains the same proportional interest in the company, the outcome is consistent with that which would be achieved in the context of a dividend.

64. Following the return of capital, no shares were cancelled. Furthermore, the individual interests as well as the relative interests of shareholders in ARL were not affected. Shareholders' rights and obligations in respect of their shares were not affected. The outcome might be considered as consistent with the payment of a dividend.

65. Noting that when ARL completes the recovery and turnaround of its loan assets including sales of underlying securities (being real properties), it will cease to trade, this circumstance inclines moderately towards the conclusion as to purpose.

## *The Part IVA matters*

66. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(2)(a) to (h).

67. In drawing a conclusion as to requisite purpose, the Commissioner should be satisfied that the scheme seeks to return an amount of capital released from cash flows arising from the realisation of the underlying securities (or real properties) for mortgage loan assets as well as the proceeds from certain legal proceedings in circumstances where the market values of the mortgage loans exceed the amounts realised. ARL considers that the amount used to fund the return of capital payment is consistent with its operations as a specialist recovery and turnaround vehicle. The practical implications of the scheme for ARL and its shareholders are consistent with the scheme being, in form and substance, a return of capital.

68. Therefore, having regard to the relevant circumstances as set out in paragraphs 47 to 67 above, it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling ARL 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 a part, of the return of capital.

## **Section 45C**

69. As the Commissioner will not make a determination under subsection 45B(3) in relation to the scheme as described, section 45C will not apply to treat any part of the return of capital as an unfranked dividend for the purposes of the ITAA 1936 or the ITAA 1997.

**Capital gains tax (CGT) consequences*****CGT event G1 – section 104-135 of the ITAA 1997***

70. CGT event G1 happened when ARL made the return of capital to an ARL shareholder in respect of a share that the shareholder owned at the Record Date as at 11:00am on 22 June 2015 and continued to own at the time of Implementation Date on 13 July 2015 (section 104-135 of the ITAA 1997).

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

72. If an ARL shareholder made a capital gain when CGT event G1 happened, the cost base and reduced cost base of the ARL share is reduced to nil. An ARL shareholder cannot make a capital loss when CGT event G1 happened (subsection 104-135(3) of the ITAA 1997).

73. If the return of capital is equal to or less than the cost base of the ARL share at the time of payment, the cost base and reduced cost base of the share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997). Where the cost base and reduced cost base of an ARL share prior to the payment exceeds 0.9 cents per share, the cost base and reduced cost base is reduced by 0.9 cents.

74. A capital gain made when CGT event G1 happened will be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided that the shareholder acquired the ARL share at least 12 months before the return of capital payment was made (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Division are satisfied. Foreign or temporary resident individuals must meet further conditions to apply the CGT discount – for CGT events occurring after 8 May 2012, the application of a CGT discount percentage will depend on:

- whether the CGT asset was held before or after 8 May 2012, and
- the residency status of the individual who has made the capital gain.

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

75. CGT event C2 happened when the return of capital was made (section 104-25 of the ITAA 1997) to an ARL shareholder that held the share at the Record Date as at 11:00am on 22 June 2015 but no longer owned the share at the Implementation Date on 13 July 2015. The right to receive the return of capital is one of the rights inherent in an ARL share held at the Record Date. If, after the Record Date but before the Implementation Date, an ARL shareholder ceased to own an ARL share in respect of which the return of capital was payable, the right to receive the return of capital was retained by that shareholder and the right constitutes a separate CGT asset.

76. The right to receive the payment ended when the right was discharged or satisfied when the payment was made.

77. An ARL shareholder made a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right. The capital gain is equal to the amount of the excess. An ARL shareholder will make a capital loss if the capital proceeds from the ending of the right are 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).

78. In working out the capital gain or capital loss made when CGT event C2 happened, the capital proceeds will be the amount of the return of capital of 0.9 cents per ARL share (subsection 116-20(1) of the ITAA 1997).

79. The cost base of the ARL shareholder's right to receive the return of capital is worked out under Division 110 (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 ARL shareholder that was applied in working out a capital gain or capital loss made when a CGT event happened to the share (when the ARL shareholder ceased to own the share) for example when the ARL shareholder disposed of the share after the Record Date.

80. Therefore, if the entire cost base or reduced cost base of the ARL 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 the return of capital is likely to result in a cost base of nil. Therefore, the ARL shareholder will generally make a capital gain equal to the amount of the return of share capital payment of 0.9 cents per share.

81. As the right to receive the return of capital was inherent in the ARL 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). Accordingly, if the ARL share was acquired at least 12 months before the return of capital payment was made, 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 that Division are satisfied. As discussed in paragraph 74 of this Explanation, from 8 May 2012, foreign or temporary resident individuals must meet further conditions to apply the CGT discount.

### **Foreign resident shareholders**

82. 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 is 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'.

83. 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).

84. A foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when a CGT event G1 happened to their ARL shares under subsection 855-10(1) if:

- the ARL shares were an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997)
- the ARL shares 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
- the ARL shares were covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

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

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

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  - ITAA 1936 45B(8)(j)
  - ITAA 1936 45B(8)(k)
- Not previously issued as a draft
- Related Rulings/Determinations:*
- ITAA 1936 45B(9)
  - ITAA 1936 45C
  - ITAA 1936 177D(2)(a)
  - ITAA 1936 177D(2)(b)
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- TR 2006/10; CR 2014/108
- Subject references:*
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- Legislative references:*
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Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events G1 to G3 – shares  
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