


CR 2017/89 - Income tax: return of capital: IWIF Holdings Limited (IWIFH)

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Class Ruling

Income tax: return of capital: IWIF Holdings Limited (IWIFH)

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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.

Summary – 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 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
- section 855-15 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares in IWIFH who:
- were listed on the IWIFH share register on 17 November 2017 (Record Date) for determining entitlements to receive the return of share capital
 - held their IWIFH shares on capital account, and
 - are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains or losses on their IWIFH shares.

In this Ruling, a person belonging to this class of entities is referred to as an 'IWIFH 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 19 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 2017 to 30 June 2018. The Ruling continues to apply after 30 June 2018 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 to the Commissioner.

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. IWIFH is an Australian unlisted public company, incorporated on 26 May 2009.
10. IWIFH is the head of an Australian income tax consolidated group.
11. IWIFH's share structure consists of 24,489,008 fully paid ordinary class shares with a total of 1,412 shareholders.
12. Approximately 98% of IWIFH's shareholders are Australian residents.

Return of Capital

13. It was resolved at a General Meeting of the members of IWIFH held on 26 June 2009 that IWIFH would be wound up following the disposal of all of its investments.
14. IWIFH finalised disposal of its investments in July 2016.
15. IWIFH made its last dividend payment to shareholders on 14 July 2016.
16. IWIFH returned capital of \$0.21 per share in the form of a cash payment to shareholders on 1 December 2017 (Payment Date).
17. The return of capital was:
 - funded out of IWIFH's remaining cash assets
 - debited to IWIFH's untainted share capital account
 - paid equally to each holder of an IWIFH share, and
 - the number of shares held by each shareholder have not changed as a consequence of the return of capital.
18. IWIFH will now enter into Members Voluntary Liquidation.

Financial Information

19. IWIFH's Consolidated Statement of Financial Position as at 1 December 2017 disclosed:
 - Issued Capital of \$7,624,004
 - Accumulated losses of \$2,167,634
 - Total Equity of \$5,456,370.

Ruling

Return of capital is not a dividend

20. The return of capital paid by IWIFH to its shareholders is not a dividend as defined in subsection 6(1).

Application of sections 45A, 45B and 45C

21. The Commissioner will not make a determination under subsections 45A(2) or 45B(3) that section 45C applies in relation to the return of capital made to IWIFH shareholders.

Capital Gains Tax (CGT) consequences

22. CGT event G1 occurred under section 104-135 of the ITAA 1997 when IWIFH paid the return of capital to its shareholders in respect of shares that the shareholder owned at the Record Date and continued to hold at the Payment Date.

23. CGT event C2 occurred under section 104-25 of the ITAA 1997 when IWIFH paid the return of capital to its shareholders in respect of shares that the shareholder owned at the Record Date but ceased to own before the Payment Date.

Foreign resident shareholders

24. An IWIFH shareholder who was a foreign resident (or the trustee of a foreign trust for CGT purposes) just before the event occurred will disregard any capital gain made when CGT event G1 happened if their IWIFH shares were not 'taxable Australian property' covered by item 3 or 5 of the table in section 855-15 of the ITAA 1997.

25. An IWIFH shareholder who was a foreign resident (or the trustee of a foreign trust for CGT purposes) just before the event occurred will disregard any capital gain or capital loss made when CGT event C2 happened if their right to receive each return of share capital was not 'taxable Australian property' covered by item 3 or 5 of the table in section 855-15 of the ITAA 1997.

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 is not a dividend

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

27. The term 'share capital account' is defined in subsection 975-300(1) 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.

28. 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.

29. The return of capital has been debited to IWIFH's untainted share capital account.

30. Therefore, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies and the return of capital is not a dividend.

Application of sections 45A, 45B and 45C

31. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfranked dividend.

Section 45A

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

33. 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.

34. The return of capital by IWIFH to its shareholders constituted the provision of a capital benefit. The capital benefits provided to all IWIFH shareholders were in proportion to their individual shareholding. As all shareholders have benefited equally from the return of capital, there will be no 'streaming' of capital benefits to some shareholders (advantaged shareholders) and not to others (disadvantaged shareholders).

35. Therefore, section 45A does not apply to the return of capital. Accordingly, 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 return of capital.

Section 45B

36. 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, who entered into or carried out the scheme or any part of the scheme did so for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Scheme

37. Subsection 995-1(1) of the ITAA 1997 defines a 'scheme' as:

- (a) any arrangement; or
- (b) any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

The return of capital to IWIFH shareholders is a scheme within the meaning given by subsection 995-1(1) of the ITAA 1997.

38. The phrase 'provided with a capital benefit' has been defined in subsection 45B(5) as:

- (a) the provision of ownership interests in a company to the person;
- (b) the distribution to the person of share capital or share premium;

- (c) something that is done in relation to an ownership interest that has the effect of increasing the value of an ownership interest (which may or may not be the same interest) that is held by the person.

39. As the return of capital has been debited to IWIFH's share capital account, shareholders were provided with a capital benefit under paragraph 45B(5)(b).

Tax Benefit

40. 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 Act

would, apart from the operation of section 45B:

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

if the capital benefit had instead been an assessable dividend.

41. A return of capital would ordinarily be subject to the CGT provisions of the income tax law. Unless the amount of the return of capital 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 return of capital 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 or in the case of a foreign resident, be subject to dividend withholding tax under section 128B. Therefore, if the return of capital did represent a dividend rather than a capital benefit, it is likely that an IWIFH shareholder would incur a greater tax liability. IWIFH shareholders therefore obtain a tax benefit from the capital return.

Relevant circumstances

42. Paragraph 45B(2)(c) requires the Commissioner to consider the 'relevant circumstances' of the scheme as set out in subsection 45B(8). Subsection 45B(8) lists the relevant circumstances of the scheme which the Commissioner must have regard to when determining whether or not a requisite purpose exists.

43. Having regard to the relevant circumstances of the scheme in returning capital to IWIFH shareholders, it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling IWIFH shareholders to obtain a tax benefit.

44. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to IWIFH's return of share capital to its shareholders.

Capital Gains Tax (CGT) consequences

CGT event G1

45. CGT event G1 (section 104-135 of the ITAA 1997) happens if a company makes a payment to a shareholder in respect of a share:

- they own in a company (except for CGT event A1 or C2 happening in relation to the share)
- some or all of the payment (the non-assessable part) is not a dividend, or an amount that is taken to be a dividend under section 47, and
- the payment is not included in the assessable income of the shareholder.

46. CGT event G1 happened when IWIFH paid the return of capital to each IWIFH shareholder in respect of each IWIFH share they owned and continued to own when the return of capital was paid (Payment Date).

47. Where the amount of capital returned to an IWIFH shareholder was more than the cost base of the IWIFH share, the IWIFH shareholder will make a capital gain. The amount of the capital gain is equal to the excess amount (subsection 104-135(3) of the ITAA 1997).

48. If an IWIFH shareholder made a capital gain when CGT event G1 happened, the cost base and reduced cost base of the IWIFH share would be reduced to nil. An IWIFH shareholder cannot make a capital loss from CGT event G1 happening.

49. If the return of capital payment of \$0.21 cents per share was equal to or less than the cost base of the IWIFH share at the time of payment, the cost base and reduced cost base of the IWIFH share would have been reduced by the amount of the return of capital payment (subsection 104-135(4) of the ITAA 1997).

50. A capital gain made when CGT event G1 happened may qualify as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the IWIFH share was acquired at least 12 months before the payment of the return of capital and the other conditions of Subdivision 115-A of the ITAA 1997 were satisfied.

CGT event C2

51. The right to receive a payment of the return of capital is one of the rights an IWIFH shareholder holds at the Record Date. If, after the Record Date but before the Payment Date, an IWIFH shareholder ceased to own some, or all, of their IWIFH shares, the right to receive a payment of the return of capital in respect of each of the shares disposed was retained by the shareholder and is a separate CGT asset.

52. CGT event C2 (section 104-25 of the ITAA 1997) occurred when the return of capital was paid. The right to receive the payment (being an intangible CGT asset) ended by the right being discharged or satisfied when the payment was made.

53. An IWIFH shareholder made a capital gain if the capital proceeds from the ending of the right were more than the cost base of the right.

54. An IWIFH shareholder made a capital loss if the capital proceeds from the ending of the right were less than the reduced cost base of the right.

55. In working out the capital gain or capital loss made from CGT event C2, the capital proceeds are the amount of the return of capital (subsection 116-20(1) of the ITAA 1997).

56. The cost base of an IWIFH shareholder's right to receive the 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 the IWIFH shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share – for example, if an IWIFH shareholder disposed of the share after the Record Date but before the Payment Date.

57. Therefore if the full cost base or reduced cost base of an IWIFH share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share, the right to receive the return of capital has a nil cost base. Therefore, the capital gain will equal the amount received (\$0.21 per share).

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

59. If an IWIFH share to which the return of capital related was originally acquired by an IWIFH shareholder at least 12 months before the payment, a capital gain from CGT event C2 happening to the right may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions of Subdivision 115-A of the ITAA 1997 were satisfied.

Foreign resident shareholders

60. Under subsection 855-10(1) of the ITAA 1997, a capital gain or loss from CGT events is disregarded if:

- (a) you are a foreign resident, or trustee of a foreign trust for CGT purposes, just before the CGT event happens; and
- (b) the CGT event happens in relation to a CGT asset that is not taxable Australian property.

61. The term 'taxable Australian property' covers five categories of CGT assets and is defined in the table in section 855-15 of the ITAA 1997. Items 1, 2 and 4 of the table in section 855-15 of ITAA 1997 do not apply to a right to receive the return of capital or an IWIFH share.

62. Accordingly, an IWIFH shareholder will disregard a capital gain from CGT event G1 or capital gain or capital loss from CGT event C2 if they are a foreign resident or the trustee of a foreign trust for CGT purposes just before the CGT event occurred and the IWIFH share was not covered by item 3 or 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

Legislative references:

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 - ITAA 1936 128B
 - ITAA 1997
 - ITAA 1997 104-25
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
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 - ITAA 1997 109-5
 - ITAA 1997 Div 110
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NO: 1-D7VWXI5

ISSN: 2205-5517

ATOlaw topic: Income tax ~~ Capital management ~~ Returning capital
~~ Share capital return

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