


CR 2021/77 - Horizon Oil Limited - return of capital

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Class Ruling

Horizon Oil Limited – return of capital

📌 Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

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What this Ruling is about

1. This Ruling sets out the tax consequences for shareholders of Horizon Oil Limited (HOL) who received the Return of Capital payment of three cents per ordinary HOL share on 23 August 2021 (Payment Date).
2. Full details of this scheme are set out in paragraphs 18 to 34 of this Ruling.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you are a holder of ordinary shares in HOL who:
 - was registered on the HOL share register on 16 August 2021 (Record Date)
 - received the Return of Capital payment of three cents per HOL share on the Payment Date
 - is an Australian resident as defined in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) or a non-resident / foreign resident (other than a non-resident who carries on a business at or through a permanent establishment in Australia), and

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- held your HOL shares on capital account; that is, you did not hold your shares in HOL as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1)).

5. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 18 to 34 of this Ruling.

6. This class of persons is referred to as 'Shareholders' throughout this Ruling.

Note: Division 230 will not apply to individuals, unless they have made an election for it to apply.

When this Ruling applies

7. This Ruling applies from 1 July 2021 to 30 June 2022.

Ruling

Return of capital is not a dividend

8. No part of the Return of Capital payment will be included in your assessable income as a dividend under subsection 44(1) of the ITAA 1936.

Sections 45A, 45B and 45C of the ITAA 1936 do not apply

9. The Commissioner will not make a determination under either subsection 45A(2) or paragraph 45B(3)(b) of the ITAA 1936 that section 45C of the ITAA 1936 applies to any part of the Return of Capital HOL paid to you on the Payment Date.

Capital gains tax consequences

CGT event G1

10. CGT event G1 (section 104-135) happened to your HOL shares on the Payment Date when HOL paid you a Return of Capital of three cents per share in respect of the HOL shares you owned at the Record Date and continued to own at the Payment Date.

11. You made a capital gain from CGT event G1 happening to your HOL shares if the Return of Capital payment of three cents per HOL share that you received on the Payment Date exceeded the total cost base of your HOL shares. The capital gain is equal to the difference. You are also required to reduce the cost base and reduced cost base of your HOL share to nil (subsection 104-135(3)). You cannot make a capital loss from CGT event G1 happening (Note 1 to subsection 104-135(3)).

12. If the amount of the Return of Capital payment of three cents per HOL share you received is equal to or less than the cost base of your share, the cost base and reduced cost base of your HOL share is reduced by the total amount of the Return of Capital payment you received for that share (subsection 104-135(4)).

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CGT event C2

13. CGT event C2 (section 104-25) happened when HOL paid you a Return of Capital payment of three cents per share in respect of HOL shares you owned on the Record Date and ceased to own before the Payment Date.

14. You make a capital gain if the amount of the Return of Capital of three cents per share is more than the cost base of your right to receive the distribution. The amount of the capital gain is equal to the difference (subsection 104-25(3)).

15. You make a capital loss if the amount of the Return of Capital is less than the reduced cost base of your right to receive the distribution. The amount of the capital loss is equal to the difference (subsection 104-25(3)).

Discount capital gain treatment available

16. You can treat a capital gain made when CGT event G1 or CGT event C2 happened to your HOL share as a discount capital gain under Subdivision 115-A if you acquired your HOL shares at least 12 months before the Payment Date (subsection 115-25(1)) and the other conditions in Subdivision 115-A are satisfied.

Foreign-resident shareholders are able to disregard a capital gains tax

17. If you were a foreign-resident shareholder or trustee of a foreign trust for capital gains tax purposes, you can disregard any capital gain made from CGT event G1 or any capital gain or capital loss made from CGT event C2 under subsection 885-10(1), as a HOL share is not an 'indirect Australian real property interest' (table item 2 of section 855-15), provided that:

- you did not use your HOL share at any time in carrying on a business through a permanent establishment in Australia (table item 3 of section 855-15), or
- your HOL share was not covered by subsection 104-165(3) about individuals who defer capital gains upon ceasing to be Australian residents (table item 5 of section 855-15).

Scheme

18. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

Background**Horizon Oil Limited**

19. HOL was incorporated in Queensland on 28 November 1969 and listed on the Australian Stock Exchange on 30 June 1981.

20. HOL was initially incorporated under the name Blight Oil & Minerals N.L. The entity changed its name to Horizon Oil N.L in 2002 and subsequently changed its name to Horizon Oil Limited in 2004.

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Source of Return of Capital

Exercise of Options

21. On 15 September 2016, IMC Investments Limited (IMC) was granted 300 million Options over ordinary shares in HOL with an exercise price of 6.1 Australian cents per Option, pursuant to the terms outlined in the Prospectus dated 15 September 2016 (the Prospectus).
22. On 18 May 2021, IMC sold these 300 million Options to Samuel Terry Asset Management Pty Ltd ATF Samuel Terry Absolute Return Fund (Samuel Terry).
23. On 1 June 2021, HOL received notice from Samuel Terry that the 300 million Options had been exercised in accordance with the terms stipulated in the Prospectus. As a result of the exercised Options, HOL received A\$18.3m (US\$14.1 million) of capital from Samuel Terry in exchange for 300 million ordinary shares in HOL.

Disposal of Papua New Guinea asset portfolio

24. In September 2009, the HOL Group executed an agreement for the sale of 50% of its interests in Petroleum Retention License 4 (PRL 4) and Petroleum Retention License 5 (PRL 5) in Papua New Guinea (PNG) to a subsidiary of Talisman Energy Inc. for US\$60 million.
25. In August 2013, the HOL Group executed an agreement for the sale of 40% of its interest in its PNG asset portfolio to Osaka Gas Co. Ltd. for US\$73 million.
26. The sale proceeds from the two disposals of PNG assets were primarily used to fund the HOL Group's PNG operations given that HOL continued to hold a presence in PNG. Residual sale proceeds (in excess of US\$16 million) were retained in the business and not distributed back to Shareholders at that time.
27. On 27 October 2020, HOL announced that it had sold 100% of the shares in its wholly-owned subsidiary located in the British Virgin Islands, Horizon Oil (PNG Holdings Limited) (Horizon PNG) to Arran Energy Investments Pty Ltd (Arran) for approximately A\$4.7 million (US\$3.5 million). Horizon PNG held all of Horizon's exploration and development licences in PNG. This completed the disposal of the last of HOL's PNG assets.
28. HOL incurred a substantial overall loss from its PNG investments such that the exit proceeds realised from the disposal of the assets were insufficient to support a dividend distribution being made to investors. On completion of the PNG divestment, the residual sale proceeds were no longer required for reinvestment in PNG, and HOL's remaining operating assets remain self-funding.

Reduced debt

29. HOL has significantly reduced its debt and gearing levels over the past three years (debt of US\$145 million as at 30 June 2016 compared to US\$12.8 million outstanding as at 30 June 2021), returning to a net cash position in March 2020.

Return of Capital

30. HOL's cash balance had grown to US\$44.1 million as at 30 June 2021 which was available for the Return of Capital. Accordingly, the additional surplus capital retained in the balance sheet could readily be returned. Considering the improved market conditions,

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the HOL Board of Directors (Board) determined on 22 July 2021 that the Return of Capital should be approximately A\$47.4 million.

31. On 10 August 2021 at the extraordinary general meeting, a majority of the Shareholders approved the Return of Capital.

32. HOL paid a Return of Capital of approximately A\$47.4 million (or US\$35 million) on its 1,578,942,962 fully-paid ordinary shares and 1.5 million partly-paid ordinary shares (three cents per share) on the Payment Date.

Rationale for Return of Capital

33. In determining the timing and quantity of the Return of Capital, the Board gave due consideration to factors including but not limited to:

- economic uncertainty due to COVID–19-related factors
- tightening liquidity in the debt capital market in conjunction with the terms of HOL's current debt facilities
- continued and sustained strengthening in oil prices over the past six months and low production costs
- retaining HOL's strong balance sheet, and
- preserving liquidity and flexibility to pursue potential growth opportunities.

34. Considering these factors, the Board determined that given the lack of growth opportunities in the market at that time, excess funds held by HOL should be returned to Shareholders by way of a return of capital, being the Return of Capital.

Commissioner of Taxation

17 November 2021

 Status: **not legally binding**

Appendix – Explanation

📌 *This Explanation 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.*

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Return of capital not a dividend

Dividend

35. The term ‘dividend’ is defined in subsection 6(1) of the ITAA 1936 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.

36. The term ‘share capital account’ is defined in section 975-300 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.

37. Subsection 975-300(2) states that where an entity has more than one eligible share capital account, it is taken to be a single account. This is the case with HOL and its ‘contributed equity’ account, which is comprised of both fully-paid and partly-paid share capital.

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

39. The Return of Capital was recorded as a debit to HOL’s untainted share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 applies and the Return of Capital is not a dividend.

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Assessable income

40. Section 44(1) of the ITAA 1936 is the key provision that deals with the taxation of distributions by companies to shareholders and equity holders.

Australian-resident Shareholders

41. Paragraph 44(1)(a) of the ITAA 1936 includes in a shareholder's assessable income any dividends paid to the shareholder out of profits derived by the company from any source if the shareholder is a resident of Australia.

42. The Return of Capital does not constitute a dividend, and no part of the Return of Capital should be included in an Australian Shareholder's assessable income pursuant to paragraph 44(1)(a) of the ITAA 1936.

Non-resident Shareholders

43. Paragraph 44(1)(b) of the ITAA 1936 includes in a shareholder's assessable income any dividends paid to the shareholder out of profits derived by the company from sources in Australia if the shareholder is a non-resident.

44. As the Return of Capital does not constitute a dividend, no part of the Return of Capital should be included in a non-resident Shareholder's Australian assessable income as the Return of Capital does not fulfil the requirements outlined in paragraph 44(1)(b) of the ITAA 1936.

Sections 45A, 45B and 45C of the ITAA 1936 do not apply

45. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of such a determination is that all or part of a capital return received by HOL shareholders is treated as an unfranked dividend paid by HOL out of profits.

Section 45A – streaming of dividends and capital benefits

46. Section 45A of the ITAA 1936 generally applies where:

- a company streams capital benefits to some shareholders who would derive a greater benefit from the receipt of capital than other shareholders (disadvantaged shareholders), and
- it is reasonable to assume that the disadvantaged shareholders have received, or are likely to receive, dividends.

47. Paragraph 45A(3)(b) of the ITAA 1936 provides that capital benefits include the distribution of share capital.

48. A capital benefit was provided to HOL Shareholders. However, the circumstances of the Return of Capital indicate that there was no streaming of capital benefits to some HOL shareholders and dividends to other HOL shareholders.

49. Accordingly, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the Return of Capital paid to HOL shareholders.

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Section 45B – scheme to provide capital benefits

50. Section 45B applies where certain payments are made to shareholders in substitution of dividends. In broad terms, section 45B of the ITAA 1936 applies where:

- there is a scheme under which a person is provided with a capital benefit by a company
- under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit, 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 the scheme or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

51. The Return of Capital satisfies the first two conditions of section 45B. However, having regard to the relevant circumstances of the scheme, it cannot be concluded that the scheme was entered into or carried out for a more than incidental purposes of enabling HOL shareholders to obtain a tax benefit.

52. Accordingly, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the Return of Capital HOL shareholders received.

Capital gains tax consequences**CGT event G1**

53. CGT event G1 happens if:

- a company makes a payment to a shareholder in respect of a share they own in the company
- 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 of the ITAA 1936, and
- the payment is not included in the shareholder's assessable income (section 104-135).

54. CGT event G1 happened to your HOL shares when you received the Return of Capital on the HOL shares which you continued to own at the Payment Date.

55. You made a capital gain when CGT event G1 happened where the amount of Return of Capital of three cents per HOL share exceeded the cost base of the share. The capital gain is equal to the amount of the excess and the cost base and reduced cost base of the HOL share is reduced to nil. No capital loss can be made from CGT event G1 (Note 1 to subsection 104-135(3)).

56. If the amount of the Return of Capital of three cents per share is less than the cost base of your HOL share, you reduce both the cost base and reduced cost base of the share (but not below nil) by the amount of the Return of Capital (subsection 104-135(4)).

CGT event C2

57. If, after the Record Date but before the Payment Date, you ceased to own a HOL share in respect of which the Return of Capital was made, the right to receive the Return of

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Capital in respect of that share is retained by you and is a separate CGT asset from the HOL share.

58. CGT event C2 happened when the Return of Capital was made. The right to receive a Return of Capital, being an intangible asset, ended by the right being discharged or satisfied when the Return of Capital was made (section 104-25).

59. You will make a capital gain under CGT event C2 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 amount. You 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)).

60. In working out the capital gain or capital loss when CGT event C2 happens, the capital proceeds are equal to the amount of the Return of Capital (three cents per share) (subsection 116-20(1)).

61. The cost base of the right to receive each Return of Capital is worked out under Division 110 (modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by you to the extent that it was applied in working out a capital gain or capital loss made when a CGT event happened to the share; for example, when you disposed of the HOL share after the Record Date and before the Payment Date. Therefore, if the cost base or reduced cost base of the HOL share previously owned by you has been fully applied in working out a capital gain or capital loss on the share, the right to receive the Return of Capital will have a nil cost base. As a result, you will, in those circumstance make a capital gain equal to the capital proceeds, being three cents per HOL share owned at the Record Date.

Foreign-resident shareholders can disregard a capital gain

62. Under subsection 855-10(1), 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.

63. Section 855-15 sets out when a CGT asset is taxable Australian property, as summarised here:

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 items 1, 2, or 5
Item 4	An option or right to acquire a CGT asset covered by items 1, 2 or 3
Item 5	A CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

64. If you were a foreign resident or trustee of a foreign trust for CGT purposes, you disregard a capital gain made if CGT event G1 happened to your HOL share or a capital gain or capital loss made if CGT event C2 happened in relation to your HOL share under

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subsection 855-10(1) because your HOL share was not an 'indirect Australian real property interest' (table item 2 of section 855-15), provided also that your HOL share:

- had not been used at any time by you in carrying on a business through a permanent establishment in Australia (table item 3 of section 855-15); or
- was not covered by subsection 104-165(3) (table item 5 of section 855-15, about individuals choosing to disregard capital gains upon ceasing to be Australian residents).

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 44(1)(a)
- ITAA 1936 44(1)(b)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(3)
- ITAA 1936 45C
- ITAA 1936 47
- 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 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-10(1)
- ITAA 1997 855-15
- ITAA 1997 975-300
- ITAA 1997 975-300(2)
- ITAA 1997 975-300(3)
- ITAA 1997 977-50
- ITAA 1997 995-1(1)
- TAA 1953

Other references:

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ATO references

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