

TR 2010/4 - Income tax: capital gains: when a dividend will be included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement

! This cover sheet is provided for information only. It does not form part of *TR 2010/4 - Income tax: capital gains: when a dividend will be included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement*

! There is a Compendium for this document: **TR 2010/4EC** .



Taxation Ruling

Income tax: capital gains: when a dividend will be included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Ruling	6
Date of effect	46
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	47
Appendix 2:	
<i>Alternative views</i>	75
Appendix 3:	
<i>Detailed contents list</i>	81

ⓘ 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 explains when, in certain cases, a dividend declared or paid:

- by an Australian resident company (the target company);
- to a resident shareholder who has disposed of shares in the target company under a contract of sale or a scheme of arrangement (the vendor shareholder),

will constitute capital proceeds under section 116-20 of the *Income Tax Assessment Act 1997* (ITAA 1997)¹ 'from the disposal' of the shares for the purposes of section 104-10². It also explains that in such cases, the dividend will not constitute part of the cost base of those shares for their purchaser.

¹ All legislative references are to the ITAA 1997 unless otherwise indicated.

² Section 104-10 defines when CGT event A1 happens.

2. This Ruling also explains the consequences for the vendor shareholder under section 118-20, where a dividend forms part of the capital proceeds from a disposal of shares.
3. This Ruling deals only with the capital gains tax (CGT) consequences arising from CGT event A1 happening to a disposal of shares under a contract, or under a scheme of arrangement under Part 5.1 of the *Corporations Act 2001* involving the transfer of shares (scheme of arrangement). It does not deal with the CGT consequences arising from CGT event A1 happening otherwise than under a contract or scheme of arrangement where the parties act at arm's length.
4. This Ruling does not deal with share buy-backs.
5. This Ruling does not consider the CGT consequences for resident shareholders who dispose of shares in non-resident companies, or non-resident shareholders who dispose of shares in resident companies.

Ruling

When a dividend will form part of the capital proceeds

6. CGT event A1 happens to the vendor shareholder in regard to shares in the target company if a change of ownership of those shares occurs from the vendor shareholder to another person under a contract for the sale of the shares or under a scheme of arrangement; that change of ownership constitutes a disposal of the shares for the purposes of this CGT event.
7. The capital proceeds from the disposal of the shares include, for the purposes of subsection 104-10(4), money the vendor shareholder has received or is entitled to receive, under the contract or under the scheme of arrangement, in respect of the transfer of the shares from the vendor shareholder to another person; such money or property is, or will be, received 'in respect of' CGT event A1 happening for the purposes of section 116-20.
8. The money a taxpayer has received, or is entitled to receive, in respect of CGT event A1 happening, and the market value of any other property the taxpayer has received or is entitled to receive, in respect of the event happening may include, in whole or part, ordinary or statutory income of the taxpayer.
9. A dividend declared or paid by the target company to the vendor shareholder will be money or property that the vendor shareholder has received, or is entitled to receive, under the contract or the scheme of arrangement, in respect of the transfer of the shares, if the vendor shareholder has bargained for the receipt of the dividend (whether or not in addition to other consideration) in return for giving up the shares. That is to say, if the dividend forms the whole or part of that sum of money or property in return for which the vendor shareholder is willing, and under the contract has promised or under the scheme of arrangement is bound, to transfer the shares in the target company, it will be capital proceeds in respect of the CGT event A1 happening.

10. A dividend will be capital proceeds of CGT event A1 happening in respect of a disposal of shares under a contract if any one or more of the following circumstances is present:

- the vendor shareholder is entitled under the contract to refuse to complete the transfer if the dividend is not declared by the target company or if the dividend is not paid by the target company; or
- the vendor shareholder is entitled to refuse to complete the transfer if a purchaser or third party does not finance or facilitate payment of the dividend; or
- the vendor shareholder has bargained for any other obligation on the part of the purchaser to bring about the result that the dividend shall be received by the vendor shareholder.

11. Similarly, a dividend will be capital proceeds of CGT event A1 happening in respect of a disposal of shares under a scheme of arrangement if the vendor shareholders' acceptance of the scheme of arrangement (by the requisite majority vote) is conditional upon one or more of the following circumstances being present:

- the dividend being declared by the target company; or
- the purchaser or a third party financing or facilitating payment of the dividend; or
- the purchaser or a third party being obliged to bring about the result that the dividend will be received by the vendor shareholders.

Example 1

12. *Acheron and Belus own all of the shares in Kronuz Pty Ltd (Kronuz), a private company incorporated in NSW. Acheron and Belus enter into a written agreement to sell the shares in Kronuz to another company, Dante Ltd (Dante). The agreement provides that the sale price of the shares is \$130 million minus a dividend amount, being the retained earnings of Kronuz available for distribution up to a maximum of \$30 million. The agreement also provides that Kronuz will declare a dividend up to a maximum amount of \$30 million prior to the completion of the sale, that Dante will upon completion of the sale pay Acheron and Belus \$100 million for the shares, and that Dante will lend money to Kronuz to enable Kronuz to pay the declared dividend to Acheron and Belus. Kronuz declared a dividend of \$30 million, and on completion Dante paid \$100 million to Acheron and Belus, and lent \$30 million to Kronuz, which paid a \$30 million dividend to Acheron and Belus.*

13. *The receipt of the dividend by Acheron and Belus and the funding of the dividend by Dante are terms of the agreement to sell the shares in Kronuz, and are part of the consideration the purchaser has agreed to pay the vendors for transfer of the shares. Capital proceeds of \$130 million (comprising the consideration of \$100 million and the dividend of \$30 million) are received by Acheron and Belus in respect of CGT event A1 happening.*

14. A dividend declared or paid by the target company to the vendor shareholder will be money or property that the vendor shareholder has received, or is entitled to receive, under the scheme of arrangement in respect of the disposal of the shares if the dividend is paid as a term of the scheme of arrangement.

Example 2

15. *Aus Ltd (Aus) is a public company listed on the Australian Securities Exchange (ASX) whose shares have been trading for about \$10. Forty per cent of its shares are owned by Yankee Inc (Yankee), a listed United States corporation.*

16. *Following discussions, the boards of Aus and Yankee execute an implementation agreement pursuant to which Yankee proposes to acquire all the shares in Aus for \$13.50 by way of a court approved members' scheme of arrangement under Part 5.1 of the Corporations Act 2001.*

17. *The implementation agreement provides that, if the scheme of arrangement is approved by the requisite majority of Aus shareholders, in consideration for the transfer of the Aus shares to Yankee, Aus shareholders will receive \$13.50 per share, comprising:*

- *scheme consideration of \$13.00 for each share held by a non-Yankee shareholder in Aus on the scheme record date; and*
- *a fully franked special dividend of \$0.50 for each share held by an Aus shareholder on the special dividend record date.*

18. *Yankee will receive the special dividend in respect of its 40% shareholding in Aus. Under the implementation agreement, if Aus does not declare and ultimately does not pay the special dividend, Yankee can exercise termination rights and not proceed with acquiring the shares in Aus.*

19. *Payment of the special dividend will be funded from cash reserves and existing debt facilities of Aus. The special dividend will be declared purely on the initiative of the Aus directors prior to the scheme of arrangement meeting, conditional upon approval of the scheme of arrangement by Aus shareholders, with a record date after the scheme of arrangement meeting, and a payment date prior to the final court approval of the scheme of arrangement.*

20. *After the execution of the implementation agreement, Aus resolves to pay a fully franked interim dividend of \$0.25 per share, payable prior to the scheme of arrangement meeting. For the past few years Aus has paid an interim or final dividend of between \$0.20 and \$0.25 every six months.*

21. *The required majority of shareholders of Aus vote for the scheme of arrangement, and the scheme is subsequently approved by a court.*

22. *The special dividend of \$0.50 is paid as a term of the arrangement. It is therefore received in respect of the disposal of the shares. Capital proceeds of \$13.50 per share (comprising the scheme consideration of \$13.00 and the special dividend of \$0.50) are received in respect of CGT event A1 happening to a shareholder who receives the special dividend.*

23. *The interim dividend of \$0.25 per share was paid in the ordinary course of Aus' business irrespective of whether or not the scheme of arrangement was approved and implemented. The \$0.25 interim dividend does not form part of the capital proceeds in respect of CGT event A1.*

24. A dividend declared and paid independently of the contract for the sale of shares is not capital proceeds from the disposal of shares in respect of CGT event A1 happening merely because payment of the dividend:

- is contingent on the sale proceeding; or
- contemporaneous with the disposal of the shares under the contract.

25. However a dividend is not declared or paid independently of the contract for the sale of shares, in the sense used in this Ruling, if the purchaser of the shares under the contract or its associate participates in arrangements in respect of the dividend that are collateral to the contract for the sale of the shares.

26. Similarly, a dividend declared and paid independently of the scheme of arrangement is not capital proceeds from a disposal of shares under a scheme of arrangement in respect of CGT event A1 happening merely because payment of the dividend is contingent (otherwise than under the scheme) on the scheme of arrangement proceeding (even if payment of the dividend is offered by the directors of the target company as an incentive for its shareholders to vote for the sale), or contemporaneous with the disposal of the shares under the scheme.

Example 3

27. *Elfin Ltd (Elfin) is a public company listed on the ASX, whose shares currently trade for about \$6. Pink PLC (Pink) is a public listed company resident in the United Kingdom. Pink does not own any shares in Elfin.*

28. *Following discussions, the boards of Elfin and Pink execute an implementation agreement pursuant to which Pink proposes to acquire all of the shares in Elfin for cash and/or shares in Pink, by way of a court approved members' scheme of arrangement under Part 5.1 of the Corporations Act 2001.*

29. *The implementation agreement provides that, if the scheme of arrangement is approved by the requisite majority of Elfin shareholders, in consideration for the transfer of their shares to Pink the shareholders in Elfin can choose to receive:*

- *cash of \$8 per Elfin share; or*
- *cash of \$4.00 and 0.45 of a Pink share per Elfin share; or*
- *0.9 of a Pink share per Elfin share.*

30. *After execution of the implementation agreement, Elfin resolves to pay:*

- *a fully franked interim dividend of \$0.10 per share, payable prior to the scheme of arrangement meeting; and*
- *a fully franked special dividend of \$0.30 per share.*

31. *The special dividend will be declared prior to the scheme of arrangement meeting, conditional upon approval of the scheme by Elfin shareholders, with a record date after the scheme of arrangement meeting and a payment date prior to the final court approval of the scheme of arrangement.*

32. *Payment of the special dividend will be funded from cash reserves and existing debt facilities of Elfin. As Pink does not own any Elfin shares, it will not receive the special dividend.*

33. *For the past few years, Elfin has paid both interim and final dividends of between \$0.10 and \$0.15 annually.*

34. *The required majority of Elfin shareholders vote for the scheme of arrangement, and it is approved by a court.*

35. *Although payment of the special dividend of \$0.30 is conditional upon shareholders' approval of the scheme of arrangement, it is not paid as a term of the scheme of arrangement. It is a distribution of profits that have accrued prior to the scheme of arrangement, that otherwise might have been expected to be subsequently distributed as a final dividend. It is therefore not received in respect of the disposal of the shares. The capital proceeds received in respect of CGT event A1 happening to a shareholder in Elfin are the cash consideration received and/or the market value of any shares in Pink received.*

36. *The interim dividend of \$0.10 per share was paid in the ordinary course of Elfin's business irrespective of whether or not the scheme of arrangement was approved and implemented. The \$0.10 interim dividend is not consideration in respect of the disposal of the shares.*

Example 4

37. *Medium Ltd (Medium) is a public company listed on the ASX, whose shares are currently trading at \$14.10 per share. Due to the global financial crisis Medium has not paid any dividends since 30 June 2008, as it sought to preserve its liquidity, even though it had the legal and financial capacity to pay dividends. Prior to that it had paid dividends 6 monthly with the average dividend being approximately 30 cents per share per annum.*

38. *On 1 June 2010, Large Ltd (Large) makes an offer to purchase Medium's shares at \$14.50 per share subject to conditions. The conditions include:*

- *minimum acceptance level of 50%;*
- *no material change to Medium's financial position during the bid period;*
- *no payment of dividends during the bid period; and*
- *the bid period expiring at the end of 3 months.*

39. *After a month, the board of Medium decides that its shareholders are entitled to a dividend and contact Large. Large subsequently agrees to vary the third condition above and permits Medium to pay its shareholders a dividend of up to 50 cents per share during the period prior to the close of the offer period. The board of Medium at that point will recommend the bid and proceed to pay an interim dividend of 50 cents per share from its existing financial capacity, regardless of whether the bid is successful.*

40. *Although the dividend is permitted under the revised offer, it is a distribution of profits that have accrued prior to the offer, that otherwise would have been expected to subsequently be distributed to shareholders as a dividend. It is therefore considered that the interim dividend of 50 cents per share is not capital proceeds from a disposal of shares in respect of CGT event A1 for those shareholders accepting the offer.*

Anti-overlap provisions

41. When a dividend forms part of the capital proceeds from the sale of shares and is also assessable income, exempt income, or non-assessable non-exempt income of the vendor shareholder, by reason of the so-called 'anti-overlap' rule in section 118-20, any capital gain of the vendor shareholder is reduced by the amount of the dividend or to zero, whichever is greater, unless one of the exceptions in section 118-20 applies. (A corresponding rule applies to a partner of a partnership for capital gains made by the partnership).

42. In this way, a dividend that forms part of a vendor shareholder's capital proceeds from the sale of shares in a resident target company will not ordinarily increase any capital gain a vendor shareholder might make from the disposal.

Effect on capital losses

43. Inclusion of a dividend in a vendor shareholder's capital proceeds from a disposal of shares will reduce a capital loss that, apart from the dividend, may have arisen from a particular disposal by the amount of the dividend.

44. Consequently, the practical effect of a dividend being included in the capital proceeds from CGT event A1 happening to a vendor shareholder in relation to shares, is that capital losses from the disposal of the shares may be less than otherwise would have been the case.

Effect on the purchaser

45. A dividend that forms the whole or a part of the capital proceeds for a vendor shareholder from a disposal of shares in respect of CGT event A1 happening is not part of the cost base of the shares for their purchaser just because the dividend forms some or all of the capital proceeds. In particular, a dividend paid by the target company to the vendor shareholders will not be part of the first element of the cost base of the shares for the purchaser under subsection 110-25(2), because it will not be money the purchaser paid, or property it gave, or is required to pay or give, in respect of acquiring the shares.

Date of effect

46. This Ruling applies to years of income commencing both before and after its date of issue. 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).

Commissioner of Taxation

30 June 2010

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.*

When a dividend forms part of the capital proceeds

General observations

47. What is the practical significance of when a dividend forms part of the capital proceeds from CGT event A1? The answer affects the extent to which a taxpayer may incur a capital loss from that event. This is because including dividends in the capital proceeds will reduce the extent to which those proceeds can fall short of the taxpayer's reduced cost base. Technically, the inclusion of dividends in capital proceeds also increases the amount of the capital proceeds where a capital gain would be made. However because dividends are almost invariably assessable income, exempt income, or non-assessable non-exempt income, that capital gain will be reduced by the anti-overlap rule in section 118-20, to the extent that they are so included, counteracting the effect of their inclusion. In practice, then, dividends will never be included in a capital gain but may be subtracted from a capital loss.

48. May income be capital proceeds? Yes; despite the name, capital proceeds need not be capital. As noted in paragraph 47 of this Ruling, the law provides that capital gains are to be reduced to the extent that capital proceeds include income. The ITAA 1997 replicates, in this respect, the scheme of the *Income Tax Assessment Act 1936* (ITAA 1936). The ITAA 1936 used the expression 'consideration', which in the ITAA 1997 is replaced by 'capital proceeds' without intention to alter the idea expressed by those terms. When the value of an asset is realised by disposal, the scheme of both the ITAA 1936 and the ITAA 1997 is to compare the full value realised by the disposal, whether received on capital or revenue account, with the cost to the taxpayer of acquiring the asset in order to reveal the gain which has been realised, and to tax it to the extent that it has not already been brought to tax as income. In this way, the law avoids the need to characterise whether a gain is on revenue or capital account for the purposes of CGT.

49. It is also the scheme of the ITAA 1997 to allow a capital loss resulting from the disposal of an asset generally only to the extent that an actual loss has been incurred, which requires income resulting from the disposal to be counted as capital proceeds in working out the loss (there are some exceptions, not presently relevant). That policy does not admit of a narrow or technical approach to the form in which value realised from the disposal is brought home to the taxpayer, but does require a realistic approach to the question, which is essentially one of fact.

50. The connection between receipt of the dividend and the disposal must therefore be real and it must be substantial. The relationship between disposal of the shares and the receipt or entitlement to receive the dividend must be one based on more than mere coincidence or caused simply by temporal proximity. However the form of the receipt as a dividend will not of itself preclude the possibility that it represents some of the value of the shares realised by the disposal and received by the vendor shareholder in return for parting with their shares.

The relevant provisions and case law

51. CGT event A1 happens to a CGT asset, which for present purposes means shares, when a change of ownership in the shares occurs from one entity to another entity. 'Entity' is defined in section 960-100 of the ITAA 1997 and in most cases refers to a legal person, but distinguishes the capacity in which a person acts. The focus of this Ruling is on the ordinary case of a transfer of ownership from one person to another person. The ordinary way in which a transfer of ownership of shares occurs is under a contract for the sale of the shares and a court approved scheme of arrangement under Part 5.1 of the *Corporations Act 2001*.

52. Under subsection 104-10(4), a taxpayer makes a capital gain from CGT event A1 if the capital proceeds 'from the disposal' exceed the share's cost base, and a capital loss is made if the capital proceeds 'from the disposal' are less than the reduced cost base of the share. 'From', is a word which usually implies a notion of source and hence in itself would tend to imply that they are capital proceeds which flow, derive, arise, or spring from the event. However subsection 116-20(1) provides that the capital proceeds a taxpayer receives 'from' a CGT event are the total of the money the taxpayer has received or is entitled to receive 'in respect of the event happening' or the market value of any other property the taxpayer has received or is entitled to receive 'in respect of the event happening'.

53. The prepositional phrase 'in respect of' usually connotes a connection of the broadest kind. When used within a statutory provision, the words 'in respect of' are capable of having:

the widest possible meaning of any expression intended to convey some connexion or relation between the two subject matters to which the words refer

(per Taylor J of the High Court of Australia in *State Government Insurance Office (Qld) v. Crittenden* (1966) 117 CLR 412 at 416; a case concerning personal injury insurance and the associated legislation).

54. Legislative history throws further light on the question. Section 116-20 of the ITAA 1997 re-enacts former provisions in section 160ZD of the ITAA 1936 defining the previous equivalent of 'capital proceeds', namely, consideration. Section 160ZD of the ITAA 1936 had identified 'the consideration in respect of the disposal of an asset' as 'the sum of the amounts of money' or 'the market value of property' a taxpayer 'has received or is entitled to receive' **'as a result of or in respect of the disposal'** (emphasis added). The expression 'as a result of' denotes a causal relationship; the addition of the words 'in respect of' had the effect of extending the possible connection between the receipt of money or property and a disposal still further. Consequently, under the former section 160ZD of the ITAA 1936, the connection between disposal and the receipt of money or property which might suffice to constitute the money or property consideration for the purposes of that Act was very broad indeed, including both causal connections and other connections. Section 1-3 of the ITAA 1997 states that, where a previous provision has been re-enacted in 'a different form of words in order to use a clearer or simpler style', the ideas expressed by the Acts are not taken to be different just because the words are different. This is such a case. Thus nothing in the legislative history of this provision suggests that 'capital proceeds' is an expression to be construed narrowly, and so confined to money and property received from the purchaser in the legal form of a price for the sale of shares.

55. Nevertheless, despite the apparent breadth of the connection between a dividend and a disposal of shares, the words 'in respect of' do not automatically embrace any connection between the two subject matters to which they refer; they take on a meaning shaped by the context in which they appear (*Federal Commissioner of Taxation v. Scully* (2000) 201 CLR 148 at 171). The present context is one of bringing to tax the profit or gain realised from a disposal of property in the form of shares. In that context there can be no reason for confining the computation of a loss, to money or property received in the legal form of the price paid for shares sold under a contract. On the other hand, when computing capital losses from the disposal of shares, it would not be consistent with the purpose of a tax on gains and losses from a disposal of property, to bring to account money or property received in substance from holding the property, rather than disposing of it. This would be the case where the link between a disposal of shares and money or property received in the form of a dividend is essentially a coincidence. In this circumstance, a dividend generally will not form part of the capital proceeds.

When a dividend generally will not form part of the capital proceeds***Dividends caused to be declared incidentally or independently***

56. If a dividend is caused to be declared or resolved to be paid before and independently of an agreement for the disposal of shares, and actual payment of the dividend is divorced from the obligations of the purchaser under the contract for the sale of shares or scheme of arrangement, the dividend will generally not form part of the capital proceeds from the disposal for the purposes of section 116-20. In other words, the dividend will not be received 'in respect of' the CGT event A1 constituted by the disposal of the shares.

57. As noted in paragraphs 52 to 55 of this Ruling, the words 'in respect of', when used in section 116-20, require that the relationship between the disposal and the receipt of the target company dividend, or the entitlement to receive such a dividend, must be one based on more than mere coincidence or caused simply by temporal proximity.

58. That is, there must be a more substantial causal and rational relationship between the disposal of shares in the target company and the receipt of, or entitlement to receive, a target company dividend, for an amount referable to that dividend to fall within the ambit of section 116-20.

59. Under a contract or scheme of arrangement, whether such a substantial causal relationship exists can only be determined by examining the individual circumstances, such as the terms of the relevant contract, the form of the assets represented by profits, the financial arrangements made to secure their distribution, and so on. However, at a practical level it may be said that where a company has profits that are both distributable in law and liquid in fact, the participation of a purchaser is not normally commercially necessary or even desirable to secure their liberation from the property of the company and distribution among the shareholders, and distribution might be expected in due course, whether the shares are disposed of or not. In these circumstances their distribution on the occasion of a sale of shares may be seen as coincidental and not in respect of the sale.

60. This is to be contrasted with the case where payment of the dividend forms part of the disposal transaction, and the purchaser participates in it in some way, so that the dividend is not purely an affair between the company and its shareholders. At a practical level this is more likely to occur when the profits are embedded in illiquid assets, particularly those necessary for the conduct of the business. Profits of this kind, given normal levels of gearing, constitute a reinvestment of profit which one would not expect to be distributed by way of dividend in the ordinary course. In these cases the real cause or source of the gain is the disposal of the shares.

When a dividend generally will form a part of the capital proceeds

61. The circumstances in which a dividend is properly seen as flowing from a disposal of shares, and hence appropriately included in the capital proceeds received in respect of the disposal, are illustrated by the facts of *Chief Commissioner of State Revenue (NSW) v. Dick Smith Electronics Holdings Pty Ltd* (2005) 221 CLR 496 (*Dick Smith Electronics*), a case concerning a vendor's liability for stamp duty on a sale of shares.

62. In *Dick Smith Electronics* the High Court was charged with ascertaining what constituted consideration under section 21 of the *Duties Act 1997* (NSW) (Duties Act) for a dutiable transaction involving the sale of shares. A 'dutiable transaction', as defined in section 8 of the Duties Act, includes a transfer of dutiable property or an agreement for the sale or transfer of dutiable property. A dutiable transaction is similar to CGT event A1, especially since no distinction is drawn between transfers and agreements to transfer. 'Dutiable property' includes shares.

63. The majority of the High Court in *Dick Smith Electronics* reasoned (at page 518) that the answer to the question of what constituted consideration in that case was to be determined by reference to what was received by the vendor shareholders for the transfer of their shares.

64. The majority also held that what was received by the vendor shareholders 'for' the transfer of their shares (that is, the consideration for the dutiable transaction under section 21 of the Duties Act) was not to be confined to the money paid directly by the purchaser to the vendor shareholders under the contract. The consideration 'for' the transfer was found to embrace all monetary amounts the contract envisaged that the vendor shareholders would receive in exchange for their promise to transfer the target company shares.

65. Under the written agreement for the sale of shares, the parties had contracted for a 'Purchase Price' of \$114,139,649, minus the 'Dividend Amount'. The Dividend Amount was prescribed as all of the retained earnings of the target company up to a maximum of \$27,000,000.

66. It was agreed in the contract that the vendor shareholders would dispose of their shares for the Purchase Price. The contract required the target company declare a dividend equal to the Dividend Amount, prior to settlement of the contract. It further required the purchaser to pay the Purchase Price on settlement and, immediately after doing so, make a facilitating loan to the target company so it could pay the requisite dividend. This ensured the vendor shareholders' receipt of the dividend was part of the total sum receivable in exchange for the shares.

67. The parties also agreed that the sale would not proceed unless the target company declared a dividend (as stipulated in the share sale contract), the purchaser paid the Purchase Price and the purchaser loaned funds necessary to pay the dividend declared by the target company.

68. The majority concluded, at pages 518 to 519, that the presence of these contractual terms indicated that the vendor shareholders had bargained for an obligation on the part of the purchaser, to bring about the result whereby they would receive \$114,139,649 for the transfer of their shares. The majority found that the purchaser discharged this obligation by paying the purchase price and funding the target company via the facilitating loan so that it could pay the dividend caused to be declared under the share sale contract, thus enabling the transfer to be completed.

69. On this basis, it was held by the majority that it was only in return for the total sum of \$114,139,649, which included the direct payment from the purchaser and the dividend amount, that the vendor shareholders were willing to dispose of their target company shares.

70. The receipt of that total sum by the vendor shareholders for their disposal of shares, and not any lesser amount, was, in accordance with the terms of the share sale contract in *Dick Smith Electronics*, held to be both the intended and actual result of the disposal provided for by the relevant share sale contract seen as a whole.

71. Despite being a case concerned with stamp duty, the reasoning of the majority in *Dick Smith Electronics* provides support for the view that a dividend may form part or all of the capital proceeds from a disposal of shares under a contract or, similarly, under a scheme of arrangement. The CGT provisions, in as much as they apply to a disposal of shares, like stamp duty, act essentially as a transactional tax.

72. Consequently, a dividend will be included in the capital proceeds when, under a contract or a scheme of arrangement, payment of the dividend is a means of placing into a vendor shareholder's hands all or part of the total sum it is agreed that the vendor shareholder will receive in exchange for parting with the shares.

Adjustment clauses

73. Generally, a contract whose terms specify a price that is to be reduced by a dividend that is payable in accordance with the contract, will be one which will bring the dividend into consideration as capital proceeds of the disposal of shares that is to occur under the contract. Similarly, one which provides for an upward adjustment in the share price in the event that a company fails to pay a dividend that is to be funded by the purchaser (or to the payment of which the purchaser is in some other way a party) will also be one which brings the dividend into consideration as capital proceeds. By way of exception, where a dividend has been declared, and is to be paid, independently of a contract for the sale of shares, that is, in circumstances such that it would be concluded that the dividend is not part of the capital proceeds for the reasons explained in this Ruling, an adjustment clause providing for an upward adjustment in the share price would not cause the dividend only for that reason to form part of the capital proceeds.

Explanation of why the dividend is not part of the purchaser's cost base

74. As indicated in paragraph 48 of this Ruling, the scheme of the ITAA 1997 in relation to the disposal by a taxpayer of a CGT asset, is to reveal the gain realised by the taxpayer from the disposal by comparing the full value realised in relation to the disposal, the 'capital proceeds', with the cost to the taxpayer of acquiring and holding the asset, the asset's 'cost base'; the two concepts are defined independently of each other. Section 110-25 defines an asset's cost base as comprising five elements which cover, generally, money the taxpayer paid or property it gave, or is required to pay or give, in respect of the acquisition, maintenance or development of the asset in question. A dividend paid by the target company to its vendor shareholders is not money the purchaser paid, or property it gave, or is required to pay or give, in respect of acquiring the shares. Accordingly, the dividend does not form part of the purchaser's cost base of the shares it acquires from the vendor shareholders.

Appendix 2 – Alternative views

❶ ***This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.***

Dividend amounts, even when received by a vendor shareholder under a contract for the sale of shares, do not form part of the capital proceeds in respect of that disposal

75. It has been suggested that a dividend paid to a vendor shareholder, immediately prior to a sale of shares, is not an amount received *'in respect of the event'* for the purposes of CGT event A1, even where the dividend is paid under the contract for the sale of shares. Rather, it should be considered an amount received in respect of a distribution of profits by the company in favour of the retiring vendor shareholder. That it might be said to be both, would be contrary to the scheme of the CGT provisions, and the scheme of the ITAA 1997 and the ITAA 1936 as a whole.

76. The argument continues by stating that such a view is undisturbed by the majority reasoning in *Dick Smith Electronics*. Recourse to that decision for CGT purposes is said to be inappropriate, as the majority judgement is based on a feature of the *Duties Act* that has no counterpart in section 116-20. Specifically, the consideration in *Dick Smith Electronics* (including the dividend), which the majority found to be the 'dutable value', was consideration for the 'agreement to transfer shares', not consideration for the 'transfer' of shares. The minority judges concluded that the dividend was not *for* the transaction. To the extent to which this is true, it is a further indication that it was the presence of the 'agreement' aspect of the NSW law that moved the majority of the High Court to include the dividend in the relevant consideration.

77. Section 116-20, on the other hand, refers to 'capital proceeds' which are defined as money or property the taxpayer receives, or is entitled to receive, in respect of an event (relevantly a 'change of ownership') happening. The section makes no reference to capital proceeds in respect of an agreement. For this reason, it is argued that the reasoning in *Dick Smith Electronics* does not apply in respect of the CGT provisions.

78. In the Commissioner's view, however, this alternative argument cannot be sustained due to the reliance section 116-20 places on the occurrence of a CGT event which, in the case of disposal of shares, is considered to be similar to a 'dutiabale transaction'. Furthermore, section 104-10 describes CGT event A1 as the disposal of a CGT asset which happens when the contract for the disposal is entered into or, if there is no contract, when the change of ownership occurs. A disposal of shares, in particular one which provides for the sale proceeds to include a dividend, would ordinarily involve and coincide with the execution of a sale contract. Therefore, were the majority reasoning in *Dick Smith Electronics* to be confined to an agreement, it would nonetheless be appropriate to have recourse to the decision in determining whether the dividend would be included as 'capital proceeds' for CGT purposes.

79. It is also argued that the promise by the purchaser to fund the payment of the dividend by the target company to the vendor was essential to the conclusion in *Dick Smith Electronics* that the dividend was received by the vendor as consideration for the dutiable transaction.

80. In the Commissioner's opinion, while the circumstances that the purchaser undertook to fund payment of the dividend were one of the several promises recorded in the agreement which led to the conclusion reached by the High Court in *Dick Smith Electronics*, it would be an unduly narrow view of the operation of the corresponding CGT provisions to assert that such a promise must be present in all cases for a dividend to form part of the capital proceeds in respect of the sale of shares.

Appendix 3 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Ruling	6
When a dividend will form part of the capital proceeds	6
<i>Example 1</i>	12
<i>Example 2</i>	15
<i>Example 3</i>	27
<i>Example 4</i>	37
Anti-overlap provisions	41
Effect on capital losses	43
Effect on the purchaser	45
Date of effect	46
Appendix 1 – Explanation	47
When a dividend forms part of the capital proceeds	47
<i>General observations</i>	47
<i>The relevant provisions and case law</i>	51
When a dividend generally will not form part of the capital proceeds	56
<i>Dividends caused to be declared incidentally or independently</i>	56
When a dividend generally will form a part of the capital proceeds	61
Adjustment clauses	73
Explanation of why the dividend is not part of the purchaser's cost base	74
Appendix 2 – Alternative views	75
Dividend amounts, even when received by a vendor shareholder under a contract for the sale of shares, do not form part of the capital proceeds in respect of that disposal	75
Appendix 3 – Detailed contents list	81

References

Previous draft:

TR 2009/D5

Related Rulings:

TR 2006/10

Subject References:

- capital gains tax
- CGT capital proceeds
- CGT cost base
- CGT event A1 – disposal of a CGT Asset
- disposal of shares
- dividend income

Legislative references:

- ITAA 1936
- ITAA 1936 160ZD
- ITAA 1997
- ITAA 1997 1-3
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 110-25
- ITAA 1997 110-25(2)

- ITAA 1997 116-20
- ITAA 1997 116-20(1)
- ITAA 1997 118-20
- ITAA 1997 960-100
- Duties Act 1997 (NSW) 8
- Duties Act 1997 (NSW) 21
- Corporations Act 2001 Pt 5.1
- TAA 1953

Case references:

- Chief Commissioner of State Revenue (NSW) v. Dick Smith Electronics Holdings Pty Ltd [2005] HCA 3; (2005) 221 CLR 496; 2005 ATC 4052; (2005) 58 ATR 241
- Federal Commissioner of Taxation v. Scully [2000] HCA 6; (2000) 201 CLR 148; 2000 ATC 4111; (2000) 43 ATR 718
- State Government Insurance Office (Qld) v. Crittenden (1966) 117 CLR 412

ATO references

NO: 1-1RKIKII

ISSN: 1039-0731

ATOLaw topic: Income Tax ~ Capital Gains Tax ~ capital proceeds
Income Tax ~ Capital Gains Tax ~ CGT event A1 – disposal of a CGT asset
Income Tax ~ Capital Gains Tax ~ cost base and reduced cost base