



# ***CR 2003/105 - Income tax: Return of Capital - Wesfarmers Limited***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2003*



## **Class Ruling**

### **Income tax: Return of Capital – Wesfarmers Limited**

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#### ***Preamble***

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a ‘public ruling’ and how it is binding on the Commissioner.*

#### **What this Class Ruling is about**

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1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

#### **Tax law(s)**

2. The tax laws dealt with in this Ruling are:

- Section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- Section 45B of the ITAA 1936 Act;
- Section 45C of the ITAA 1936 Act;
- Division 136 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- Section 202-45 of the ITAA 1997.

#### **Class of persons**

3. The class of persons to whom this Ruling applies is the ordinary shareholders in Wesfarmers Limited (‘Wesfarmers’) who hold shares on the record date (being 15 December 2003) and who will receive the capital return (‘Arrangement’) announced on 3 November 2003.

## Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the Arrangement described below at paragraphs 10 to 18 is carried out in accordance with the details of the Arrangement provided in this Ruling.
6. If the Arrangement described in this Ruling is materially different from the Arrangement that is actually carried out:
  - (a) this Ruling has no binding effect on the Commissioner because the Arrangement entered into is not the Arrangement on which the Commissioner has ruled; and
  - (b) this Ruling may be withdrawn or modified.
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## Date of effect

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8. This Ruling applies to the year ended 30 June 2004. The Arrangement will be completed within that income year.

## Withdrawal

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9. This Class Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling.

## **Arrangement**

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10. The Arrangement that is the subject of the Ruling is described below. This description is based on the Class Ruling request dated 23 September 2003, and letters dated 8 October 2003 and 23 October 2003 from Greenwoods & Freehills Pty Limited.

**Note:** certain information received from Wesfarmers has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information Legislation.

11. Wesfarmers announced a return of capital ('Capital Return') on 3 November 2003.

12. Prior to making this announcement, Wesfarmers had determined that it had surplus capital to its requirements and that it wished to increase the gearing ratio of the company whilst ensuring that its current dividend policy can be maintained.

13. As at 30 June 2003, shareholders equity comprised approximately \$3,758.5 million, of which approximately \$3,159.5 million represented share capital. The share capital of Wesfarmers has progressively increased over a number of years, particularly due to the high take-up under its dividend reinvestment plan (which has now been suspended). In addition, Wesfarmers' share capital also increased significantly in the 2002 financial year due to the acquisition of Howard Smith Limited (around 79 million new shares were issued as consideration for the acquisition).

14. As at 31 August 2003, Wesfarmers had approximately 376.5 million ordinary shares (the 'Shares') on issue. The Capital Return will be up to a total maximum of \$950 million (equivalent to \$2.50 per Share).

15. Having regard to the factors outlined in paragraphs 12 and 13, Wesfarmers considered that it is appropriate to debit the whole amount of the aggregate Capital Return to its share capital account.

16. All shareholders who hold Shares on the record date (being 15 December 2003) will receive the Capital Return.

17. The Capital Return will be funded by using general working capital and existing debt facilities and a release of capital formerly invested in the Wesfarmers' rural services business that has been recently sold.

18. As at 30 August 2003, less than 1% of the registered shareholders of Wesfarmers were non-residents. Moreover, Wesfarmers estimated that 57% of its Shares were held by individuals and 43% held by institutions.

## Ruling

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19. The Commissioner will not make a determination (under section 45A(2) or section 45B(3) of the ITAA 1936) that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Return received by the holders of the Shares.

20. Non-resident shareholders who receive the Capital Return will make no capital gain pursuant to section 136-10 of the ITAA 1997, provided the non-resident shareholder (and its associates) beneficially owned less than 10% by value of the Shares during the 5 years before the Capital Return.

## Explanation

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21. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C of the ITAA 1936 that all or part of the Capital Reduction Amount received by the shareholders is treated as an unfranked and non-rebatable dividend.

### Section 45A

22. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or would receive dividends (the disadvantaged shareholder).

23. Wesfarmers will provide shareholders with a 'capital benefit' (as defined in section 45A(3)(b) of the ITAA 1936). However, there is nothing in the circumstances of the Capital Return to indicate that there is a 'streaming' of capital benefits to some shareholders who are advantaged shareholders, and dividends to other shareholders, being disadvantaged shareholders, as all shareholders will receive the Capital Return. Therefore section 45A of the ITAA 1936 has no application to the Capital Return.

**Section 45B**

24. Section 45B of the ITAA 1936 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, 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

25. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are met, the requisite purpose of enabling the shareholder to obtain a tax benefit – by way of a capital distribution – is not present. The purpose of the Capital Return is to return capital surplus to its present requirements to shareholders and to increase its gearing ratio. The tax profiles of the wide class of shareholders are not all known to Wesfarmers and as such, the purpose of ensuring that particular shareholders obtain a tax benefit cannot exist.

26. Having regard to the relevant circumstances of the scheme – set out in subsection 45B(8) of the ITAA 1936 – it cannot be concluded that either Wesfarmers or the participating shareholders entered into or carried out the scheme for the purpose of enabling such shareholders to obtain a tax benefit:

- (a) The Capital Return cannot be said to be attributable to the profits of Wesfarmers as most of the profits (with the exception of minimal retained earnings) are returned to shareholders as franked dividends. The history of dividend payments by Wesfarmers does not indicate that the Capital Return is being paid in substitution for a dividend. It does not intend to alter its dividend policy as a consequence of the Capital Return.
- (b) As at 30 June 2003, 84% of the shareholders' equity attributable to members of Wesfarmers comprised of share capital, which resulted from the issue of new shares for acquisition of Howard Smith Limited, the high take-up of the dividend reinvestment plan and the operation of the employee share plan. To increase the

gearing ratio, Wesfarmers expects the funds for the Capital Return will be sourced from a combination of working capital, existing debt facilities and a release of capital formerly invested in the Wesfarmers' rural services business that has recently been sold.

- (c) All shareholders who acquired their shares on or after 20 September 1985 will receive the Capital Return which will give rise to a capital gains tax event. For most of the shareholders, the cost base of their Wesfarmers shares is substantially higher than the Capital Return of \$2.50 per share. The result is that they are required to reduce the cost base of their shares by \$2.50 per share. Some shareholders who acquired shares on or after 20 September 1985 and before August 1988 have a cost base of between zero and \$2.50, therefore these shareholders will realise a capital gain equal to the excess of the Capital Return of \$2.50 over the cost base of the Wesfarmers shares. For those shareholders who acquired their shares prior to 20 September 1985, the Capital Return will have no capital gains tax consequences.

Therefore, section 45B of the ITAA 1936 will not apply to the Arrangement and the Commissioner will not make a determination pursuant to section 45C of the ITAA 1936.

### **Division 136**

27. Section 136-10 of the ITAA 1997 states that a non-resident shareholder will not make a capital gain on a capital payment for shares unless the shares have the necessary connection with Australia.

28. Relevantly, a non-resident shareholder and its associates must have (at any time during the 5 years immediately before the Capital Return) held at least 10% by value of the Shares in order for the Shares to have the necessary connection with Australia.

29. Where a non-resident shareholder and/or its associates were beneficial owners of less than 10% by value of the shares of Wesfarmers at any time during the 5 years immediately before the Return of Capital, the non-resident shareholder and/or its associates will not be liable for capital gains tax on the capital return.

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## Detailed contents list

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30. Below is a detailed contents list for this Class Ruling:

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### Commissioner of Taxation

26 November 2003

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	- ITAA 1936 45A
<i>Previous draft:</i>	- ITAA 1936 45A(2)
Not previously issued as a draft	- ITAA 1936 45A(3)(b)
	- ITAA 1936 45B
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(3)
CR 2001/1; TR 92/1; TR 97/16	- ITAA 1936 45B(2)(a)
	- ITAA 1936 45B(2)(b)
	- ITAA 1936 45B(2)(c)
<i>Subject references:</i>	- ITAA 1936 45B(5)
- Capital Reduction	- ITAA 1936 45C
	- ITAA 1997 136
<i>Legislative references:</i>	- ITAA 1997 136-10
- Copyright Act 1968	- ITAA 1997 202-45
- TAA 1953 Part IVAAA	

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ATO references

NO: 2003/15445

ISSN: 1445-2014