

CR 2004/104 - Income tax: return of capital: Minara Resources Limited

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Class Ruling

Income tax: return of capital: Minara Resources Limited

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Preamble

*The number, subject heading, **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

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

Tax law

2. The tax law dealt with in this Class Ruling is section 45B of the *Income Tax Assessment Act 1936* (ITAA 1936). This ruling does not cover the application of the capital gains and losses provisions of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies is the shareholders in Minara Resources Limited (MRE) who receive a return of share capital consisting of cash under the arrangement as described below.

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 actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 20.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- 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
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies to the year ended 30 June 2005 unless and until it is withdrawn (see paragraph 9 of this Ruling). However this Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 21 to 22 of Taxation Ruling TR 92/20). Furthermore this Ruling applies to the extent that the relevant tax laws are not amended.

Withdrawal

9. This Class Ruling is withdrawn and ceases to have effect after 30 June 2005. 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. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons involved in the arrangement.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or the relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- the Class Ruling request dated 11 June 2004;
- the letters dated 13 July 2004, 30 July 2004, 13 August 2004 and 23 August 2004 from KPMG Perth providing additional information;
- MRE's financial statements for the year ended 30 June 2004;
- the Settlement Agreement dated 5 May 2004.

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

11. MRE is an Australian listed company and the holding company of a group engaged in mining. The principal activity of the MRE Group is the operation of the Murrin Murrin nickel and cobalt open pit mine and processing facilities (the Murrin Murrin Project), which is owned by the Murrin Murrin Joint Venture (MMJV). MRE holds a 60% interest in the Murrin Murrin Project through its wholly owned subsidiary Murrin Murrin Holdings Pty Ltd (MMH).

12. MRE proposes to seek approval, at a general meeting of shareholders, to make a return of capital to its shareholders of 20 cents per share in November or December 2004. The total amount to be returned is \$92.3 million. All shareholders will participate equally in the return of capital, based on the number of shares held by each shareholder.

13. The return of capital will be sourced from cash received by MMH, which is MMH's 60% share of a settlement payment concerning the MMJV.

14. Since construction of the Murrin Murrin Project commenced in April 1997 ongoing difficulties have been experienced in the construction and operation of the project plant, resulting in substantial funds being spent in rectifying and modifying the plant. Most of these costs were capitalised to the cost of plant and equipment in the accounts of the joint venturers.

15. For the year ended 30 June 2002 the accounts of the MRE consolidated group (formerly Anaconda Nickel Limited) show provisions and write-downs to the carrying value of property, plant and equipment of \$508 million, which were expensed and contributed to the accumulated losses of the group. These provisions and write-downs were primarily attributable to the numerous cost and production problems experienced in the construction and operation of the project plant.

16. The operator of the MMJV made a series of claims against the constructor in relation to defects in the plant and misrepresentations concerning the design of the processing facility. The claims were for past and future plant rectification costs incurred by the joint venturers. In May 2004, the joint venturers agreed to settle all their claims against the constructor of the processing facilities, in return for certain undissected settlement payments. MMH's share of the settlement proceeds was \$93 million, which will be the source of the funds for the proposed distribution.

17. Since its incorporation in July 1993 MRE has not paid any dividends, not has it undertaken any return of capital or share buy-backs.

18. The largest shareholder of MRE is a non-resident company which holds 49.65% of the issued shares. Other non-resident shareholders held less than 1% of the issued shares in MRE as at 31 August 2004, with the remaining shares held by residents of Australia for income tax purposes.

19. MRE's Statement of Financial Position as at 30 June 2004 shows total shareholders' equity \$550.7 million (consolidated group: \$581.7 million), consisting of \$862.0 million (consolidated group: the same) in contributed share capital and \$311.3 million (consolidated group: \$280.3 million) in accumulated losses.

20. MRE's Statement of Financial Performance also records an operating profit of \$145.4 million (consolidated group: \$173.3 million) for the year ended 30 June 2004. The group operating profit includes the \$93 million share of the settlement proceeds.

Ruling

21. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the return of capital distribution to MRE shareholders. The distribution will, therefore, not be taken to be a dividend for income tax purposes.

Explanation

Section 45B of the ITAA 1936

22. Section 45B of the ITAA 1936 is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C of the ITAA 1936 applies to treat all or part of a return of capital payment as an unfranked dividend.

23. Section 45B of the ITAA 1936 applies where certain amounts of a capital nature, including a return of capital, are provided to shareholders in substitution for dividends. Subsection 45B(2) sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) that section 45C applies. These conditions are that:

- there is a **scheme** under which a person is **provided with a capital benefit** by a company;
- under the scheme a person (the relevant 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, 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 a taxpayer to obtain a tax benefit**.

Each of these conditions is considered below.

24. The proposed return of capital is a 'scheme' within the broad meaning of that term.

25. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). A person is provided with a capital benefit if:

- ownership interests in a company are issued to the person;
- there is a distribution to the person of share capital; or
- the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest held by that person.

As MRE proposes to debit the distribution to its share capital account, its shareholders will be provided with a capital benefit.

26. A taxpayer 'obtains a tax benefit', as defined in subsection 45B(9), where:

- the amount of tax payable; or
- any other amount payable under the ITAA 1936 or the ITAA 1997,

by the taxpayer 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 a dividend.

27. A return of capital, ordinarily, would be subject to tax under the capital gains and losses provisions of the income tax law. Unless the amount of the proposed distribution exceeds the cost base of the shares (which MRE has advised is not expected to occur) there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). This will happen if the shareholder is a resident of Australia for income tax purposes, or a non-resident whose shares are CGT assets having the necessary connection with Australia (category number 5 of the table in section 136-25 of the ITAA 1997).

Shareholders would therefore obtain a 'tax benefit', as defined in subsection 45B(9), under the arrangement.

28. As the conditions of paragraphs 45B(2)(a) and (b) are satisfied, the remaining condition in paragraph 45B(2)(c), that is, whether the requisite degree of purpose (of enabling MRE shareholders to obtain a tax benefit) is present, must be considered.

29. Paragraph 45B(2)(c) sets out an objective purpose test, having regard to 'the relevant circumstances of the scheme', in determining whether a person entered into or carried out a scheme for a more than incidental purpose of enabling a relevant taxpayer to obtain a tax benefit. The list of relevant circumstances in subsection 45B(8) is not exclusive and not all factors listed will be relevant to every scheme. Under the arrangement, the relevant taxpayers are MRE shareholders.

30. Paragraph 45B(8)(a) refers to the extent to which a capital benefit is attributable to capital or to realised and unrealised profits of the company and its associates. Although MMH's share of the settlement proceeds will be the source of funds for the proposed distribution, and these proceeds were accounted for as a profit in MRE's consolidated Statement of Financial Performance for the 2004 financial year, the proposed distribution is, for the purposes of this paragraph, attributable to capital rather than profits. MMH's share of the settlement proceeds does not compensate for loss of profits, but for losses arising from deficiencies in the construction and commissioning of the Murrin Murrin Project. In substance, the settlement proceeds represent a partial recoupment of losses that resulted from provisions and write-downs of plant and equipment which were included in the measurement of the company's consolidated financial performance in the 2002 financial year. The cost of plant and equipment was effectively financed by capital contributed by MRE shareholders, who bore the effect of the provisions and write-downs through losses charged to shareholders' equity. These losses are, in effect, being recouped, in part, by MMH's share of the settlement proceeds.

31. Although MMH's share of the settlement proceeds will, appropriately, be accounted for as a profit in MRE's consolidated financial statements, it is effectively restoring some of the capital that has been invested in the Murrin Murrin Project. To the extent provisions and write-downs to plant and equipment were reflected in accumulated losses of both MMH and MRE, some of the capital contributed by MRE shareholders had been accounted for as lost. The share of settlement proceeds recoup some of those losses, and therefore restore some of the lost capital. As the proposed distribution is to be sourced entirely from MMH's share of the settlement proceeds, it is appropriately attributable to capital subscribed by MRE shareholders and therefore is not attributable to profits for the purposes of section 45B. This factor tends against finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

32. Paragraph 45B(8)(b) of the ITAA 1936 refers to the pattern of distribution of dividends, bonus shares and returns of paid up capital by the company or its associates. MRE has not made distributions of either profit or capital to the shareholders in the past, even though the MRE consolidated group is now producing profits from ordinary activities of the MMJV. This factor tends toward rather than against finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

33. Paragraph 45B(8)(c) is concerned with the extent to which the distribution would enable shareholders to recoup capital losses. MRE has advised that, having regard to the history of MRE's share price, it is not expected that any shareholder will derive capital gains as a result of the distribution that might have been applied to recoup any capital losses they may have. This factor tends against finding the requisite degree of purpose of enabling MRE shareholders to obtain a tax benefit.

34. Paragraph 45B(8)(e) is concerned with the resident status of shareholders. The shareholders of MRE include both residents and non-residents, however, the holdings of non-resident shareholders that do not constitute CGT assets having the necessary connection to Australia is small. This factor is therefore not significant relative to other relevant circumstances.

35. Paragraph 45B(8)(h) considers whether the shareholder's equity interest in the company is the same before and after the distribution of share capital. As the proposed distribution of 20 cents per share does not affect the proportionate interests of MRE shareholders, this factor tends toward the existence of the requisite degree of purpose.

36. Paragraph 45B(8)(k) refers to any of the matters covered in subparagraphs 177D(b)(i) to (viii) of the ITAA 1936. These matters include, among other things, the form and substance of the scheme and its financial implications for the parties to it. In the circumstances of the arrangement, these matters are not considered to incline for or against a conclusion as to existence of the requisite degree of purpose.

37. Having regard to all the circumstances outlined in paragraphs 30 to 36 above, it is concluded that the arrangement as described will not be entered into for a more than incidental purpose of obtaining a tax benefit for MRE shareholders.

38. Therefore, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the distribution proposed under the arrangement.

Detailed contents list

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

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Commissioner of Taxation

29 September 2004

<i>Previous draft:</i>	- ITAA 1936 45B
Not previously issued as a draft	- ITAA 1936 45B(2)
	- ITAA 1936 45B(2)(a)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(2)(b)
CR 2001/1; TR 92/1; TR 97/16;	- ITAA 1936 45B(2)(c)
TR 92/20	- ITAA 1936 45B(3)
	- ITAA 1936 45B(5)
	- ITAA 1936 45B(8)
<i>Subject references:</i>	- ITAA 1936 45B(8)(a)
- Capital benefit	- ITAA 1936 45B(8)(b)
- Dividend substitution	- ITAA 1936 45B(8)(c)
- Return of capital	- ITAA 1936 45B(8)(e)
	- ITAA 1936 45B(8)(h)
<i>Legislative references:</i>	- ITAA 1936 45B(8)(k)
- Copyright Act 1968	- ITAA 1936 45B(9)
- TAA 1953 Part IVA	- ITAA 1936 45C

- ITAA 1936 177D(b)(i)
 - ITAA 1936 177D(b)(ii)
 - ITAA 1936 177D(b)(iii)
 - ITAA 1936 177D(b)(iv)
 - ITAA 1936 177D(b)(v)
 - ITAA 1936 177D(b)(vi)
 - ITAA 1936 177D(b)(vii)
 - ITAA 1936 177D(b)(viii)
 - ITAA 1997 104-135
 - ITAA 1997 136-25
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ATO references

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