

CR 2004/153 - Income tax: Return of Capital: Wesfarmers Limited

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Class Ruling

Income tax: Return of Capital: Wesfarmers Limited

Contents	Para
What this Class Ruling is about	1
Date of effect	9
Withdrawal	10
Arrangement	11
Ruling	21
Explanation	24
Detailed contents list	39

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 laws' identified below apply to the defined class of persons, who take part in the Arrangement to which this Ruling relates.

Tax laws

2. The tax laws dealt with in this Class Ruling are:
- section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 45B of the ITAA 1936;
 - section 45C of the ITAA 1936;
 - section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - Division 136 of the ITAA 1997; and
 - section 202-45 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of Wesfarmers Limited ('Wesfarmers') who received the capital return which was first announced by Wesfarmers on 14 December 2004 and described in the Arrangement part of this Ruling. In this Ruling they are referred to as participating shareholders.

4. This Class Ruling does not apply to Wesfarmers and does not deal with how the taxation law applies to Wesfarmers in relation to the return of capital. Furthermore, it should be noted that certain information which relates to the affairs of Wesfarmers, but is not in the public domain, has been taken into account in determining the application of certain anti-avoidance provisions in this Ruling. This information cannot be disclosed in the Ruling.

Qualifications

5. The Commissioner makes this Ruling based on the precise Arrangement identified in this Ruling.

6. 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 11 to 20.

7. 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

9. This Class Ruling applies to the year ended 30 June 2005. The Arrangement will be completed within that income year. The Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2005. This Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement during the term of the Ruling, subject to there being no change in the Arrangement or in the person's involvement in the Arrangement.

Arrangement

11. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or 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:

- Application for the Class Ruling from Greenwoods & Freehills Pty Limited, dated 28 September 2004 and later correspondence;
- 2004 Annual Report;
- Various press releases; and
- List of top 40 shareholders as at 31 August 2004.

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

12. Wesfarmers announced a return of capital ('Capital Return') on 14 December 2004.

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

14. As at 30 June 2004, shareholders equity comprised approximately \$3,332.6 million, of which approximately \$2,345.6 million represented share capital. Wesfarmers' share capital has progressively increased over a number of years, particularly due to the high take-up under its dividend reinvestment plan (suspended in February 2003) and the issue of shares under Wesfarmers' Employee Share Plan. In addition, Wesfarmers' share capital 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).

15. Wesfarmers' had hoped to achieve an appropriate gearing ratio through the return of capital of December 2003 together with the completion of its on-market share buy-back programme. However, while still operative, as a means of capital management the latter programme has not achieved the targeted gearing ratio.

16. Note 20 of the Wesfarmers 2004 Annual Report sets out the share capital as at 30 June 2004. Wesfarmers had approximately 376.4 million ordinary shares (the 'Shares') on issue. The return of capital will be \$1.00 per Share.

17. Having regard to the factors outlined in paragraphs 13 and 14, Wesfarmers considered that it was appropriate to debit the whole amount of the return of capital to its share capital account.

18. All shareholders who hold Shares on the record date (expected to be 25 February 2005) will receive the return of capital.

19. The return of capital will be funded by using general working capital, releases of capital formerly invested in businesses sold by Wesfarmers and existing bank facilities.

20. As at 30 June 2004, less than 1% of the registered shareholders of Wesfarmers were non-residents. Moreover, Wesfarmers estimated that 59% of its Shares were held by individuals and 41% held by institutions.

Ruling

21. The Commissioner will not make a determination under either subsection 45A(2) or 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 received by the holders of the Shares.

22. The return of capital will give rise to CGT event G1 (section 104-135 of the ITAA 1997). The cost base and reduced cost base of each share in respect of which the payment is made will be reduced (but not below nil) by the return of capital amount (subsections 104-135(3) and (4) of the ITAA 1997). Also, a participating shareholder will make a capital gain from CGT event G1 happening in respect of a share to the extent that the payment exceeds the share's cost base (subsection 104-135(3) of the ITAA 1997).

23. Non-resident shareholders who participate in the return of capital 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 at all times during the 5 years before the return of capital.

Explanation

Anti-avoidance provisions

24. 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 return of capital amount received by the shareholders is treated as an unfranked and non-rebatable dividend.

Section 45A

25. 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 shareholders).

26. Wesfarmers will provide shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936). However, there is nothing in the circumstances of the return of capital 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 return of capital. Therefore, section 45A of the ITAA 1936 has no application to the return of capital.

Section 45B

27. 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)).

28. In the circumstances of the Arrangement, the conditions of paragraph 45B(2)(a) and (b) are satisfied, as the proposed payment of the return of capital will provide shareholders with a capital benefit.

29. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the circumstances set out under subsection 45B(8) to determine whether any part of the Arrangement would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

30. The purpose test is an objective one. The question is whether, objectively, it would be concluded that a person who entered into or carried out the scheme, did so for the purpose of obtaining a tax benefit for the relevant taxpayer in respect of the capital benefit. The purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

31. In this regard, the relevant taxpayers are Wesfarmers shareholders. After consideration of all the relevant circumstances, the Commissioner has decided that the capital reduction represents a genuine return of capital to Wesfarmers' shareholders. The purpose of the return of capital is to return capital surplus to Wesfarmers requirements and to increase its gearing ratio.

32. The return of capital cannot be said to be attributable to Wesfarmers' profits as most profits are returned as franked dividends. Wesfarmers has indicated that it will continue and not alter its dividend policy.

33. As with the 2003 return of capital, Wesfarmers expects the funds for this year's return of capital will be sourced from a combination of working capital, existing debt facilities, and releases of capital formerly invested in businesses sold by Wesfarmers.

34. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the return of capital.

35. As the Commissioner will not make a determination pursuant to subsection 45B(3) in relation to the Arrangement as described, section 45C will not deem the return of capital provided to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

Capital Gains

CGT event G1

36. The return of capital will give rise to CGT event G1 (section 104-135 of the ITAA 1997). The cost base and reduced cost base of each share in respect of which the payment is made will be reduced (but not below nil) by the return of capital amount (subsections 104-135(3) and (4) of the ITAA 1997). Also, a participating shareholder will make a capital gain from CGT event G1 happening in respect of a share to the extent that the payment exceeds the share's cost base (subsection 104-135(3) of the ITAA 1997).

Division 136

37. 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.

38. 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.

Detailed contents list

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

	Paragraph
What this Class Ruling is about	1
Tax laws	2
Class of persons	3
Qualifications	5
Date of effect	9
Withdrawal	10
Arrangement	11
Ruling	21
Explanation	24
Anti-avoidance provisions	24
<i>Section 45A</i>	25
<i>Section 45B</i>	27
Capital Gains	36
<i>CGT event G1</i>	36
<i>Division 136</i>	37
Detailed contents list	39

Commissioner of Taxation

22 December 2004

Previous draft:

Not previously issued as a draft

- capital gains tax
- capital streaming
- dividend streaming arrangements

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 97/16

- dividends
- return of capital on shares

Subject references:

CR 2004/153

Legislative references:

- Copyright Act 1968
 - TAA 1953 Pt IVAAA
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)(b)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(5)(b)
 - ITAA 1936 45B(8)
 - ITAA 1936 45C
 - ITAA 1997 104-135
 - ITAA 1997 Div 136
 - ITAA 1997 136-10
 - ITAA 1997 202-45
 - ITAA 1997 995-1
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ATO references

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