CR 2006/122 - Income tax: GRD Limited - reduction of capital

Class Ruling

Income tax: GRD Limited – reduction of capital

Contents Para

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, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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 sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 128B of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997; and
- section 136-10 of the ITAA 1997.

All references in this Ruling are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is the holders of ordinary shares in GRD Limited (GRD) and who are registered on the GRD share register on the Record Date, being the date for determining entitlements to participate in the proposed return of capital described in paragraphs 13 to 23 of this Ruling. In this Ruling, those entities are referred to as 'GRD shareholders'.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 23 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

Date of effect

8. This Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) ending 30 June 2007. However, the 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 the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

9. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

12. This Class Ruling is withdrawn and ceases to have effect after 30 June 2007. However, the Ruling continues to apply after its withdrawal in respect of the taxation provisions ruled upon, to all entities within the specified class who enter into the specified scheme during the term of the Ruling subject to there being no change in the scheme or in the entities' involvement in the scheme.

Scheme

13. The scheme that is the subject of this Ruling is described below. The 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 scheme are:

- the Class Ruling application, accompanying financial statements and other information from Deloitte Touche Tohmatsu Ltd (Deloitte) dated 27 September 2006;
- correspondence providing further particulars dated 16 October 2006, 19 October 2006 and 8 November 2006 from Deloitte; and
- notice of general meeting and explanatory statement for reduction of capital.

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

14. GRD is an Australian engineering, development and operating company.

15. On 18 May 2006 GRD divested itself of approximately 50% holding in one of its gold mining interests which it had sourced with funds from the share capital account as one of its 'founding assets'. This released capital of approximately $145.8 million which was used to support the growth strategies of GRD's engineering and waste-to-resources business.

16. On 8 September 2006, GRD sold its remaining 6.9% shareholding in the gold mining interest. This sale generated cash of approximately $19.25 million. GRD believes the cash holdings generated from this disposal are in excess of its current capital requirements and therefore proposes to distribute this surplus capital back to its shareholders.

17. The directors have considered that a capital return to shareholders in the short-term is responsible and appropriate capital management strategy in respect of the surplus cash.

18. The proposed return of capital was approved by shareholders at GRD's annual general meeting on 20 October 2006. In accordance with that approval, GRD's Board of Directors determined that:

- the amount of the capital return will be $0.10 per ordinary share held by shareholders on the register on 27 October 2006 (the Record Date);
- payment of the capital return to shareholders was effected on 3 November 2006; and
- GRD securities have traded on an 'ex return of capital' basis from 23 October 2006.

19. No shares will be cancelled as a result of the proposed return of capital, nor will there be any dilution to the shareholdings in GRD.

20. GRD will debit the return of capital against its share capital account which consists of only one class of ordinary shares.

21. GRD confirms that its share capital account as defined in section 975-300 of the ITAA 1997 is untainted.

22. GRD intends to maintain in future the same dividend policy where it has in the main consistently paid both interim and final unfranked dividends.

23. GRD has advised that the proposed return of capital will not impact on its ability to pay dividends in subsequent financial years.

Ruling

Distribution is not a dividend for income tax purposes

24. As the proposed return of capital will be debited to GRD's share capital account it will not be a dividend, as defined in subsection 6(1).

Sections 45A, 45B and 45C

25. The Commissioner will not make a determination under subsection 45(A)(2) or 45B(3) that section 45C applies to the proposed return of capital. Accordingly, no part of the proposed return of capital will be taken to be a dividend for income tax purposes.

Capital gains tax (CGT)

26. CGT event G1 will happen when GRD pays the return of capital of $0.10 per share to the GRD shareholders (section 104-135 of the ITAA 1997).

27. CGT event C2 will happen when GRD pays the return of capital of $0.10 per share to resident GRD shareholders who cease to own their GRD shares after the Record Date but before the Payment Date (section 104-25 of the ITAA 1997).

28. A foreign resident shareholder may make a capital gain as a result of the return of capital if the relevant asset (the GRD share) has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Commissioner of Taxation
13 December 2006

Appendix 1 – Explanation

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.

Distribution is not a dividend for income tax purposes

29. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to a shareholder out of profits derived by the company from any source (if a resident of Australia for tax purposes) and from an Australian source (if non-resident).

30. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, later paragraphs in that subsection exclude certain items from being a dividend for income tax purposes.

31. The definition of 'dividend' specifically excludes:

> moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

32. Share capital account is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

33. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount, to which Division 197 of the ITAA 1997 applies, is transferred to the account and the account is not already tainted.

34. As GRD has confirmed that the proposed return of capital will be debited to their untainted share capital account, paragraph (d) of the definition of dividend in subsection 6(1) applies and the return of capital would not constitute a dividend.

Anti-avoidance provisions

35. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of the return of capital amount received by the shareholders as an unfranked dividend.

Section 45A – streaming of dividends and capital benefits

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

37. GRD will be providing its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)) under the proposed capital return. However, having considered the relevant circumstances of the proposed capital return, it cannot be concluded that capital benefits and dividends are being channelled by GRD to its shareholders, in a manner that enables advantaged shareholders to receive capital benefits while disadvantaged shareholders will receive dividends. This is because the proposed capital reduction is an 'equal reduction' as contemplated by section 256B(2) of the *Corporations Act 2001*. It applies to all GRD shareholders in proportion to the number of GRD shares they hold and the terms of the capital reduction are the same for each holder of GRD shares.

38. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the proposed return of capital.

Section 45B – schemes to provide capital benefits

39. The purpose of section 45B is to ensure that the relevant amounts distributed to shareholders are treated as dividends for tax purposes if certain payments, allocations and distributions are made 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)).

Each of the conditions is considered below.

Scheme

40. A scheme for the purposes of section 45B is defined in subsection 177A(1) to include:

- any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- any scheme, plan, proposal, action, course of action or course of conduct.

41. The arrangement involving the proposed capital return will constitute a scheme for the purposes of section 45B.

42. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) and includes a distribution to a person of share capital. As GRD proposes to debit the proposed return of capital against its untainted share capital account, its shareholders will be provided with a capital benefit.

Tax benefit

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

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

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.

44. Ordinarily, a return of capital would be subject to the CGT provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the shares, there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). It is only to the extent (if any) that the distribution exceeds the cost base of the shares that a capital gain arises. A capital gain may not arise at all for certain foreign resident shareholders: see paragraph 63 of this Ruling. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or in the case of a foreign resident, be subject to dividend withholding tax under section 128B of the ITAA 1936. Therefore, GRD shareholders will obtain tax benefits from the return of capital.

Relevant circumstances

45. For the purposes of paragraph 45B(2)(c) the Commissioner is required to consider the relevant circumstances (as outlined in subsection 45B(8)) of the scheme with a view to determine whether it could be concluded that entities that 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 the relevant taxpayer to obtain a tax benefit.

46. The test of purpose 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. The purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

47. The relevant circumstances under subsection 45B(8) cover both the circumstances of the company and the shareholders. In this instance, as the proposed return of capital is made to all GRD shareholders regardless of their individual circumstances, paragraphs 45B(8)(c) to (h) do not incline for, or against, a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(i) and (j), pertaining to the provision of ownership interests and demerger, are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

48. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, GRD has decided to return to GRD shareholders contributed share capital that was realised upon the sale of the remaining 6.9% interest GRD held in the gold mining interest on 8 September 2006. The sale of the 6.9% interest did not generate an accounting gain for GRD Ltd as the sale price of $0.77 per share was less than the carrying value of the interest of $0.81 per share. This sale generated cash of approximately $19.25 million. GRD believes the cash holdings generated from the disposal of this interest are in excess of its current capital requirements and therefore proposes to distribute this surplus capital back to its shareholders.

49. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate (within the meaning of section 318) of the company. GRD has consistently paid interim and final unfranked dividends. GRD intends to maintain its current dividend policy. The proposed return of capital will be made in addition to the payment of the declared interim dividend in respect of the year ended 31 December 2006. Accordingly, the company's pattern of distributions does not suggest that the proposed return of capital will be made in substitution for a dividend.

50. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (viii). These are matters by reference to which a scheme is able to be examined from a practical perspective in order to identify and compare its tax and non-tax objectives. The matters include the manner in which the scheme is carried out, its form and substance, and its financial and other implications for the persons involved. GRD has demonstrated that the scheme, being a return of capital to its shareholders is a legitimate return of surplus capital.

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

Section 45C – deeming dividends to be paid where determinations under section 45A or 45B are made

52. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) in relation to the scheme, as described, section 45C will not deem any part of the proposed return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or of the ITAA 1997.

CGT event G1 – section 104-135 of the ITAA 1997

53. CGT event G1, in section 104-135 of the ITAA 1997, will happen when GRD pays the proposed return of capital amount in respect of a share that a GRD shareholder owned in the company at the Record Date, and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

54. GRD proposes to make a payment to GRD shareholders out of its untainted share capital account. This payment will not be a dividend as defined in subsection 995-1(1) of the ITAA 1997. If the proposed return of capital amount of $0.10 cents per share is not more than the cost base of the GRD share at the time of the payment, the cost base and reduced cost base of the share are reduced by the amount of the proposed return of capital (subsection 104-135(4) of the ITAA 1997).

55. A GRD shareholder will make a capital gain if the proposed return of capital amount is more than the cost base of their GRD share (subsection 104-135(3) of the ITAA 1997).

56. If a GRD shareholder makes a capital gain, the cost base and reduced cost base of the share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

57. A GRD shareholder cannot make a capital loss under CGT event G1.

CGT event C2 – section 104-25 of the ITAA 1997

58. If, after the Record Date but before the Payment Date, a GRD shareholder ceases to own some, or all, of their shares in GRD, the right to receive the payment in respect of each of the shares disposed of is considered to be a separate CGT asset. That right is one of the rights inherent in the share at the Record Date and is retained by the shareholder when the share is sold.

59. The right of a GRD shareholder to receive the payment will be discharged or satisfied when the payment is made under the scheme, causing CGT event C2 in section 104-25 of the ITAA 1997 to happen. In working out the capital gain or capital loss made from CGT event C2, the capital proceeds will be the proposed return of capital amount.

60. The cost base of the GRD shareholder's right to receive a payment under the scheme is worked out in accordance with Division 110 of the ITAA 1997. As no amount will have been paid for the right, its cost base is likely to be nil. Therefore, a capital gain equal to the payment of the return of capital will likely arise.

61. Because the right to the payment of the proposed return of capital amount was inherent in the share during the time it was owned, the right is considered to have been acquired at the time when the share was acquired (section 109-5 of the ITAA 1997).

62. Consequently, if the share to which the payment relates was originally acquired by a GRD shareholder at least 12 months before the payment of the proposed return of capital amount, a capital gain from CGT event C2 happening to the right may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Foreign resident shareholders – Division 136 of the ITAA 1997

63. A foreign resident GRD shareholder will not make a CGT event G1 capital gain unless their shares have the necessary connection with Australia (section 136-10 of the ITAA 1997). Under category 5 of the table in section 136-25 of the ITAA 1997, a share, or an interest in a share, in a resident public company will have the necessary connection with Australia if at any time during the 5 years before the payment of the proposed return of capital, the foreign shareholder, together with their associates, owned at least 10% by value of the shares in the company.

64. As rights to receive a return of capital cannot have the necessary connection with Australia (section 136-25 of the ITAA 1997) there will be no CGT event C2 gain or loss for a foreign GRD shareholder.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Subject references:

- capital benefit
- capital reductions
- return of capital
- share capital

Legislative References:

- ITAA 1936 6(1)
- ITAA 1936 44(1)
- 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)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(c)
- ITAA 1936 45B(8)(d)
- ITAA 1936 45B(8)(e)
- ITAA 1936 45B(8)(f)
- ITAA 1936 45B(8)(g)
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(i)
- ITAA 1936 45B(8)(j)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 128B
- ITAA 1936 177A(1)
- 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 1936 318
- 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 109-5
- ITAA 1997 Div 110
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20
- ITAA 1997 136-10
- ITAA 1997 136-25
- ITAA 1997 197-50
- ITAA 1997 197-50(1)
- ITAA 1997 197-50(2)
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- ITAA 1997 995-1(1)
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Corporations Act 2001 256B(2)

ATO references

NO: 2006/24728
ISSN: 1445-2014
ATOlaw topic: Income Tax ~~ Return of capital
Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 – shares
Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 – end of a CGT asset