


# ***CR 2007/22 - Income tax: return of capital: Incremental Petroleum Ltd***

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## Class Ruling

### Income tax: return of capital: Incremental Petroleum Ltd

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#### **ⓘ 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. This Ruling does not deal with the capital gains tax consequences of the scheme. This Ruling does not address the application of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) to the scheme or to an associated or wider scheme of which the scheme is a part.

#### **Relevant provision(s)**

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

- subsection 6(1) of the ITAA 1936;
- subsection 45A(2) of the ITAA 1936;
- subsection 45B(3) of the ITAA 1936; and
- section 45C of the ITAA 1936.

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

## Class of entities

3. The class of entities to which this Ruling applies is all shareholders of Incremental Petroleum Ltd who receive a return of capital as described in paragraphs 12 to 20 of this Ruling.

## Qualifications

4. 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 12 to 20 of this Ruling.

5. 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.

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## Date of effect

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7. This Ruling applies from 1 July 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

8. 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).

## **Scheme**

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12. The scheme 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 the documents incorporated into this description of the scheme are:

- Class Ruling request from Tax Centre Consultants Pty. Ltd. dated 7 August 2006;
- Financial records of Incremental Petroleum Ltd (IPL) for the years ended 30 June 2005 and 2006; and
- Correspondence from IPL providing further particulars dated 5 October 2006.

13. IPL was incorporated on 7 August 2005 to acquire all of the shares in a group of companies that ultimately own the Selma Oilfield in Turkey. By a public offer of 30 August 2005, IPL raised \$61 million by issuing 61 million fully paid \$1 shares.

14. The amount raised was intended to cover the cost of purchasing the entities and the cost of the float, and to provide working capital for the company. At the time of the float, the precise capital requirements of the company were not known.

15. IPL's Board now proposes to return to shareholders share capital which is excess to the company's requirements. The estimated amount of excess share capital is \$3.4 million.

16. The relevant funds were raised on the float of the company and at all times have been retained in a separate bank account. The return of capital will be paid from this bank account.

17. IPL does not have any profits either realised or in respect of an asset revaluation reserve.

18. IPL has not previously paid dividends to its shareholders. However, IPL expects to pay dividends to shareholders in the future.

19. The comparative rights and interests held by the shareholders after the distribution will be the same as those that would have been held had an equivalent dividend been paid instead of the capital benefit.

20. The share capital will be returned to all shareholders in proportion to the number of shares held.

## Ruling

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21. As the return of capital will be paid from the initial share float subscriptions and, it will be debited to IPL's share capital account, it will not be a dividend as defined in subsection 6(1).

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

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**Commissioner of Taxation**

28 March 2007

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## 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.*

### Dividend

23. Subsection 44(1) includes in a shareholder's assessable income a dividend, as defined by subsection 6(1), which is paid to the shareholder out of company profits.

24. Broadly, section 44 requires a shareholder in a company to include in its assessable income any dividends paid to the shareholder by a company out of profits derived by the company from any source (if resident in Australia) and from an Australian source (if non-resident). In order for section 44 to have application, the amount paid must constitute a 'dividend'.

25. 'Dividend' is defined in subsection 6(1) to include any distribution made by a company to any of its shareholders. However, this broad definition is confined by later paragraphs in the definition which expressly exclude certain items from being a dividend for income tax purposes.

26. One such specific exclusion is paragraph (d) of the definition of dividend which provides:

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.

27. As the return of capital will be debited against IPL's share capital account, paragraph (d) of the definition of dividend applies to exclude the distribution from falling within the definition of dividend. Accordingly, the return of capital will not be regarded as a dividend unless some other more specific provisions in either the ITAA 1936 or *Income Tax Assessment Act 1997* (ITAA 1997) operate to make it a dividend.

28. For instance, if IPL's share capital account was tainted, any distribution debited to that account will be treated as a dividend. However, IPL's share capital account is not tainted for the purposes of section 197-50 of the ITAA 1997, as no amounts have been transferred to its share capital account from any of its other accounts. Accordingly, the share capital account satisfies section 975-300 of the ITAA 1997 and is available to fund capital distributions that will not be treated as dividends under subsection 6(1) of the ITAA 1936.

29. Another such provision is subsection 6(4) which provides that paragraph (d) of the definition of dividend does not apply if the capital distribution forms part of an arrangement where the company raises share capital from certain shareholders and then makes a capital distribution to other shareholders. However, in the scheme described IPL has no plans to undertake a corresponding raising of share capital and therefore subsection 6(4) does not apply to the return of capital.

### **Sections 45A, 45B and 45C**

#### ***Section 45A – streaming of dividend and capital benefits***

30. Section 45A applies in circumstances where capital benefits are streamed to advantaged shareholders who would, in the year of income in which the capital benefits are provided, derive a greater benefit from the return of capital than the other shareholders (the disadvantaged shareholders) who would have received or would receive dividends.

31. IPL will provide its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), and the capital benefit will be provided to all shareholders in direct proportion to the number of shares held. As all shareholders benefit equally from the return of capital, there is no 'streaming' capital benefits to some shareholders and not to others. Accordingly, section 45A does not apply to the return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the return of capital.

#### ***Section 45B – schemes to provide capital benefits in substitution for dividends***

32. Section 45B 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)).

33. Therefore, the following elements need to be satisfied before section 45B will apply to this scheme:

- the return of capital is a scheme for the purposes of section 45B;
- the shareholders will be 'provided with a capital benefit' as defined in subsection 45B(5) by IPL under the proposed return of capital (the definition includes a distribution of share capital); and
- the IPL shareholders will obtain a tax benefit under the scheme.

34. The shareholder '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 shareholder 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.

### ***Relevant circumstances***

35. 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 scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

36. 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 (or any part of it), 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.

37. In this case, the relevant taxpayers are the shareholders of IPL. The relevant circumstances of this scheme are:

- the proposed return of capital can be traced directly to share capital funds raised at the time of the float and retained in a separate bank account at all times since;
- as at 31 December 2005, IPL derived a net profit of \$9,506.00 and at 30 June 2006 had a net loss of \$332,050.00; and
- the return of capital is the excess to the company's requirements of the initial capital raised from the share float and is not attributable to profits.



38. Having regard to the circumstances outlined in paragraph 33 of this Ruling, it is considered that the scheme, as described, will not be entered into for the purpose, not being an incidental purpose, of enabling a shareholder of IPL to obtain a tax benefit.

39. Although a tax benefit will be provided to the shareholders of IPL, any benefit is merely incidental. It is accepted that the purpose of the return of capital is to enable IPL to return to shareholders the initial capital that is excess to its requirements.

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

41. 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 the return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Subject references:*

- return of capital
- share capital

*Legislative references:*

- 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(9)
  - ITAA 1936 45C
  - ITAA 1936 Pt IVA
  - ITAA 1997 197-50
  - ITAA 1997 975-300
  - Copyright Act 1968
  - TAA 1953
  - TAA 1953 Sch 1 357-75(1)
  - ITAA 1936 6(1)
  - ITAA 1936 6(4)
  - ITAA 1936 44
  - ITAA 1936 44(1)
  - ITAA 1936 45A
  - ITAA 1936 45A(2)
  - ITAA 1936 45A(3)(b)
  - ITAA 1936 45B
- 

ATO references

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