


CR 2008/53 - Income tax: return of capital: Emperor Mines Limited

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Class Ruling

Income tax: return of capital: Emperor Mines Limited

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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.

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);
 - subsection 45A(2) of the ITAA 1936;
 - subsection 45B(3) of the ITAA 1936;
 - section 45C of the ITAA 1936;
 - section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-135 of the ITAA 1997;
 - Subdivision 115-A of the ITAA 1997; and
 - section 855-10 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are all shareholders of Emperor Mines Limited (EML) who were entitled to receive, and were paid a return of capital from EML as described in paragraphs 13 to 21 of this Ruling (the participating 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 was carried out in accordance with the scheme described in paragraphs 13 to 21 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.

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Date of effect

8. This Ruling applies from 1 July 2007 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

9. The Ruling does not apply to taxpayers to the extent that it conflicts with the 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.

10. If this 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)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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.

12. 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

13. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for Class Ruling from EML dated 11 October 2007;
- a copy of the financial report for EML for the year ended 30 June 2007;
- a copy of the notice of general meeting and accompanying explanatory memorandum for the EML shareholder meeting that occurred on 30 July 2007; and
- correspondences from PwC dated 20 December 2007, 13 February 2008, and 1 April 2008.

Note: certain information received from and on behalf of EML was provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

14. EML is a company incorporated in Australia, and at the time of making the capital return, was listed on the Australian Stock Exchange (ASX). It is the parent entity of a group that carries out gold mining and exploration activities throughout the Pacific region. As at 27 August 2007 EML had 1,046,005,621 fully paid ordinary shares on issue.

15. EML acquired 100% of the issued capital of DRD Isle of Man Limited on 17 November 2005 at a cost of US\$237,330,000 or A\$312,360,000. At the time of acquisition, DRD Isle of Man held assets in the form of 100% of the Tolukuma Gold Mine and 100% of DRD Porgera Ltd which held 20% interest in the Porgera Joint Venture. The Porgera Joint Venture owned the Porgera Gold Mine and the 20% interest in the Joint Venture was valued at A\$287million.

16. The Porgera Joint Venture interest was sold by DRD Porgera Ltd in April 2007. After transaction costs and the repayment of debts the net proceeds of the sale were A\$285million. Subsequent to the sale EML had surplus cash of approximately A\$125,000,000.

17. At a general meeting on 30 July 2007, the shareholders of EML resolved to reduce its share capital by paying the sum of \$0.05 per share to each EML shareholder (the Capital Reduction Amount) in order to return surplus cash.

18. Entities registered as shareholders in EML on 27 August 2007 (the Record Date) were entitled to participate in the return of capital. On the Record Date, EML had foreign resident shareholders.

19. The total amount of capital returned was A\$52,300,281, which was paid to the participating shareholders on 3 September 2007. After undertaking the capital reduction, EML has retained the remaining cash surplus generated by the sale of the Joint Venture interest to fund future growth.

20. Prior to the payment of the Capital Reduction Amount, no transfers previously took place to taint EML's share capital account. EML has not paid a dividend to its shareholders since listing on the ASX in 1999.

21. Historically, EML has recognised significant accounting losses in relation to write-downs of its mining and exploration interests and trading performance. There were significant losses realised during the 2007 financial year.

Ruling

Return of capital is not a dividend

22. As the Capital Reduction Amount has been debited to EML's untainted Share Capital Account, it will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

Return of capital will not be a deemed dividend under section 45C

23. 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 payment of the Capital Reduction Amount paid to the participating shareholders. Accordingly, no part of the return of capital will be taken to be a dividend for income tax purposes.

Capital gains and losses

24. CGT event G1 (section 104-135 of the ITAA 1997) happened when EML paid the Capital Reduction Amount in respect of EML shares that the participating shareholders owned at the time of the payment.

25. CGT event C2 (section 104-25 of the ITAA 1997) happened when EML paid the Capital Reduction Amount to the participating shareholders in respect of EML shares that they ceased to own before the time of the payment.

26. Any capital gain arising under either CGT event G1 or CGT event C2 will be a discount capital gain provided the relevant conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Foreign resident shareholders

27. A foreign resident shareholder in EML who was paid the Capital Reduction Amount disregards any capital gain made when CGT event G1 happened, if at the time of the payment their EML shares were not 'taxable Australian property' (section 855-10 of the ITAA 1997).

28. A foreign resident shareholder in EML who had the right to payment of the Capital Reduction Amount disregards any capital gain made when CGT event C2 happened to that right, because at the time of the payment the right was not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation6 August 2008

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.*

Distribution is not a dividend

29. The definition of 'dividend' in subsection 6(1) of the ITAA 1936 has the effect that any distribution made by the company to any of its shareholders, whether in money or property, is a dividend except where the distribution is debited against an amount standing to the credit of the Share Capital Account of the company (paragraphs (a) and (d) of the definition).

30. The distribution was debited against EML's untainted share capital account. Therefore, the distribution was not a dividend for the purposes of subsection 6(1) of the ITAA 1936 to the extent of such debiting.

Distribution will not be a deemed dividend under section 45C

31. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions, which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfranked dividend that is paid by a company out of profits to a shareholder under section 45C of the ITAA 1936.

Streaming of dividends and capital benefits: section 45A

32. Section 45A of the ITAA 1936 allows the Commissioner to make a determination that section 45C of the ITAA 1936 applies to a capital benefit. The effect of such a determination is that all or part of the distribution of capital received by the shareholders under the return of capital is treated as an unfranked dividend.

33. Section 45A of the ITAA 1936 is an anti-avoidance provision that applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of share capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

34. EML has provided all of its shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b) of the ITAA 1936 and the capital benefit has been provided to all of the shareholders in direct proportion to their individual shareholding. As all shareholders benefit equally from the return of capital, there is no indication of 'streaming' of capital benefits to some shareholders and not to others.

35. Accordingly, section 45A of the ITAA 1936 does not apply to the return of capital and the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the return of capital to the shareholders of EML.

Schemes to provide capital benefits in substitution for dividends: section 45B

36. Section 45B of the ITAA 1936 applies where certain payments are made to shareholders in substitution for dividends.

37. Subsection 45B(2) of the ITAA 1936 sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies. These conditions are that:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
- under the scheme, a taxpayer (the relevant taxpayer) who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b) of the ITAA 1936); and
- having regard to the relevant circumstances of the scheme, it could be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

38. In this case, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of enabling the eligible shareholder to obtain a tax benefit (by way of capital distribution) was not present.

39. Having regard to the relevant circumstances of the scheme, set out in subsection 45B(8) of the ITAA 1936, it cannot be concluded that any of the parties to the scheme entered into or carried out the scheme for more than an incidental purpose of obtaining a tax benefit in the form of a capital benefit. The Capital Reduction Amount cannot be said to be attributable to the profits of EML, nor do the pattern of distributions indicate that it is being paid in substitution for a dividend.

40. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the return of capital.

Application of section 45C

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

Capital gains and losses

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

42. CGT event G1 happened when EML paid the Capital Reduction Amount in respect of a share that a Participating Shareholder owned at the time of the payment, as the payment was not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

43. Where the Capital Reduction Amount of \$0.05 per share is not more than the cost base of an EML share at the time of the payment, the cost base and reduced cost base of the share will be reduced by the amount of the Capital Reduction Amount (subsection 104-135(4) of the ITAA 1997).

44. A Participating Shareholder will make a capital gain if the Capital Reduction Amount is more than the cost base of their EML share (subsection 104-135(3) of the ITAA 1997). The amount of the capital gain is equal to that excess.

45. If a Participating Shareholder acquired the EML share before 20 September 1985, any capital gain made from CGT event G1 is disregarded (subsection 104-135(5) of the ITAA 1997).

46. Where a Participating Shareholder makes a capital gain from CGT event G1, the cost base and reduced cost base of the EML share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

47. A Participating Shareholder cannot make a capital loss when CGT event G1 happens.

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

48. If before the payment of the Capital Reduction Amount, a Participating Shareholder ceased to own some or all of their EML shares, the right to receive payment of the Capital Reduction Amount in respect of each of the shares disposed is considered to be a separate CGT asset. That right was retained by the Participating Shareholder when the EML share was sold.

49. CGT event C2 in section 104-25 of the ITAA 1997 happened when the Capital Reduction Amount was paid and the right to receive that payment ended.

50. In working out the capital gain or capital loss made from CGT event C2, the capital proceeds will be the Capital Reduction Amount (subsection 116-20(1) of the ITAA 1997).

51. The cost base of the (former) EML shareholder's right to receive payment of the Capital Reduction Amount is worked out in accordance with Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As no amount would have been paid for the right, its cost base is likely to have been nil. Therefore, a capital gain equal to the payment of the return of capital is likely to have arisen.

52. As the right to payment of the Capital Reduction 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).

53. If a participating shareholder acquired the EML share to which the payment relates before 20 September 1985, any capital gain made from CGT event C2 is disregarded (paragraph 104-25(5)(a) of the ITAA 1997).

Discount capital gains

54. If a share to which payment of the Capital Reduction Amount relates was originally acquired by an EML shareholder at least 12 months before the payment, a capital gain from the happening of CGT event G1 or C2 may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

55. The CGT discount may be available to Participating Shareholders who make a discount capital gain from payment of the Capital Reduction Amount, that are individuals, complying superannuation entities, trusts or a life insurance company (section 115-10 of the ITAA 1997).

56. However, the CGT discount will not be available for a capital gain from the happening of CGT event G1 to an EML share, where the capital gain was worked out by reference to an indexed cost base (section 115-20 of the ITAA 1997).

Foreign resident shareholders

57. A foreign resident that was an EML shareholder on the Record Date disregards any capital gain or capital loss made when CGT event C2 happened to the right to receive payment of the Capital Reduction Amount because the right was not taxable Australian property at that time.

58. A foreign resident EML shareholder disregards a capital gain or capital loss made from the happening of CGT event G1 to their shares provided those shares were not 'taxable Australian property' at the time the Capital Reduction Amount was paid (section 855-10 of the ITAA 1997). The term 'taxable Australian property' is described in the table in section 855-15 of the ITAA 1997 and covers five categories of CGT assets. Broadly, these CGT asset categories are:

- (1) taxable Australian real property which is held directly;
- (2) indirect Australian real property interests which are not covered by category 5 below;
- (3) CGT assets used in carrying on a business through an Australian permanent establishment which are not covered by categories 1, 2 or 5;
- (4) options or rights to acquire a CGT asset covered by categories 1, 2 or 3; and
- (5) CGT assets in respect of which a capital gain or loss was deferred when an individual ceased to be an Australian resident.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

- return of capital on shares

Legislative references:

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