CR 2010/31 - Income tax: van Eyk Three Pillars Limited: proposed return of capital and share consolidation

Class Ruling

Income tax: van Eyk Three Pillars Limited: proposed return of capital and share consolidation

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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 provisions 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 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997;
- section 112-25 of the ITAA 1997; and
- section 855-10 of the ITAA 1997.

All legislative references are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies are the shareholders of van Eyk Three Pillars Ltd (VTP) who:

- are registered on the VTP share register on the Record Date, being the date for determining entitlements under the proposed return of capital as described in paragraphs 9 to 25 of this Ruling; and
- hold their shares on capital account; and
- are not subject to the Taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their shares.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them).

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 9 to 25 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 from 1 July 2010 to 30 June 2011. The Ruling continues to apply after 30 June 2011 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant.

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

10. VTP is an Australian investment company which was incorporated in October 2003. VTP was listed on the Australian Securities Exchange (ASX) on 28 January 2004. There is only one class of shares on issue, being ordinary shares.

11. VTP's principal activity is investment in ASX listed securities primarily drawn from the ASX 300.

12. On 29 September 2009, VTP shareholders elected a new Board who were mandated to conduct a detailed strategic review of options to achieve:

- an increased value of VTP shares; and
- mechanisms for shareholders to realise their investment in VTP at, or near to, the value of each share's Net Tangible Asset (NTA) backing, including a significant return of capital.

On-market share buy-back

13. On 29 September 2009, VTP shareholders also approved an on-market buy-back of up to 25% of VTP's issued shares. Between October 2009 and January 2010 VTP had acquired 18,368,679 shares representing approximately 14% of the total number of shares on issue at the commencement of the buy-back.

14. On 22 January 2010, the buy-back was suspended until approval for the proposed return of capital was obtained from shareholders on 8 April 2010. The buy-back was suspended on, and has not been active since, 22 January 2010.

Proposed return of capital

15. On 22 February 2010, VTP announced that it proposed to make a return of capital to shareholders. As VTP shares have consistently traded at a discount to their NTA backing, the proposed return of capital is aimed at delivering shareholders approximately 95% of the value of VTP's gross tangible assets.

16. The proposed return of capital will be sourced solely from the realisation by VTP of approximately 95% of its portfolio of investments (the Portfolio).

17. The proposed return of capital was approved by shareholders at a general meeting held on 8 April 2010 and will be applied equally to each shareholder of a VTP share on the Record Date, which is proposed to be six business days after the end of the period in which the Portfolio is to be realised (Payment Date).

18. The proposed return of capital will be made by way of cash distribution in proportion to the number of shares held on the Record Date. Payment of the cash distribution is expected to be made 11 business days after the end of the period in which the Portfolio is to be realised.

19. VTP will debit the entire amount of the proposed return of capital against its untainted share capital account. There will be no change in the proportionate interest of each VTP shareholder in VTP as a result of the proposed return of capital.

Share consolidation

20. After the proposed return of capital, VTP proposes to consolidate its shares on a 20 for 1 basis. If the consolidation results in a shareholder being entitled to a part of a share, that entitlement will be rounded up to the nearest whole share.

21. The proposal to consolidate its shares was approved by shareholders at the general meeting of 8 April 2010. The share consolidation will take place with effect from 6:00 pm on the Record Date.

22. No shares in VTP will be cancelled as a result of the consolidation of VTP shares and there will be no change to VTP's share capital. There will be no change to the proportionate interests held by each shareholder. VTP shareholders will not receive capital proceeds for the reduction in the number of shares on issue.

Other aspects

23. As at 31 December 2009, VTP had total equity of $116,037,397 represented by contributed equity of $123,295,696 and retained losses of $7,258,299. At that date, VTP had 110,891,751 ordinary shares on issue.

24. VTP has consistently paid dividends to VTP shareholders in respect of each of the income years from and including 30 June 2005 to 30 June 2008. On 25 August 2009 VTP paid an interim dividend in respect of the income year ending 30 June 2010.

25. Should the proposed return of capital proceed, there will be a significant reduction in the scale of VTP's Portfolio. VTP is unable to provide assurances that it will continue to pay future dividends.

Ruling

Distribution is not a dividend

26. The proposed return of capital to VTP shareholders will not be a dividend, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C to the proposed return of capital

27. The Commissioner will not make a determination under section 45A that section 45C applies to the cash distribution.

28. The Commissioner will not make a determination under section 45B that section 45C applies to the cash distribution

Capital gains tax

29. CGT event G1 (section 104-135 of the ITAA 1997) will happen when VTP pays the proposed return of capital to a VTP shareholder in respect of a VTP share that they own at the Record Date and continue to own at the Payment Date.

30. CGT event C2 (section 104-25 of the ITAA 1997) will happen when VTP pays the proposed return of capital to a VTP shareholder in respect of a VTP share they own at the Record Date but cease to own before the Payment Date.

Foreign resident shareholders

31. A foreign resident VTP shareholder who is paid the proposed return of capital disregards any capital gain made when CGT event G1 happens if their VTP share is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

32. A foreign resident VTP shareholder who is paid the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens if their right to receive the proposed return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Share consolidation

33. No CGT event will occur as a result of the consolidation of shares in VTP (section 112-25 of the ITAA 1997).

Commissioner of Taxation
28 July 2010

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

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

35. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) excludes a distribution from the meaning of 'dividend' if the amount of that distribution is debited to the credit of the company's share capital account.

36. The term '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 on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

37. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted.

38. The proposed return of capital will be recorded as a debit to VTP's share capital account. As the share capital account of VTP is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies. Accordingly, the proposed return of capital would not constitute a dividend.

The application of sections 45A, 45B and 45C to the proposed return of capital

39. Sections 45A and 45B 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 the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

40. Section 45A applies where capital benefits are streamed to some shareholders (the advantaged shareholders) who derive a greater benefit from the capital benefits than other shareholders (the disadvantaged shareholders) and these disadvantaged shareholders receive, or are likely to receive, dividends.

41. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in subsection 45A(3) to include the distribution to the shareholder of share capital. The proposed return of share capital in the present case by VTP to its shareholders will constitute the provision of a capital benefit. However, as VTP proposes to make a pro-rata return of capital to all of its shareholders in respect of their ordinary shares in VTP, there will be no streaming of capital benefits to some shareholders and not to others.

42. Therefore, section 45A will have no application to the proposed return of capital. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the capital benefit.

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

43. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. The effect of such a determination is that all or part of the distribution of capital received by the shareholder is treated as an unfranked dividend.

44. In broad terms, section 45B 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, 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

45. Each of these conditions is considered below.

Scheme

46. A 'scheme' for the purposes of section 45B is taken to have the same meaning as provided in subsection 177A(1) of Part IVA. That definition is widely drawn and includes any agreement, arrangement, understanding, promise, undertaking, scheme, plan or proposal.

47. Accordingly, the proposed return of capital will constitute a scheme.

Capital benefit

48. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). It states that a person is provided with a capital benefit if:

- an ownership interest in a company is 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 (which may or may not be the same interest) held by that person.

49. As the amount of the proposed capital return will be debited to VTP's share capital account, its shareholders will be taken to have been provided with a capital benefit under paragraph 45B(5)(b).

Tax benefit

50. A taxpayer 'obtains a tax benefit', as defined in subsection 45B(9) of the ITAA 1936, 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 of the ITAA 1936:

- 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.

51. Ordinarily, a return of capital would be subject to the capital gains tax provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the share, 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 is made. A capital gain may not arise at all for certain foreign resident shareholders. 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. Accordingly, VTP shareholders will obtain tax benefits from the proposed return of capital.

Relevant circumstances of the scheme

52. The proposed capital distribution in this instance will be funded from the realisation of the Portfolio. Whilst a minimal profit may arise from the realisation, the attribution of the proposed distribution to both share capital and any such profit must be considered having regard to all the relevant circumstances as set out in subsection 45B(8). VTP's pattern of distributions does not indicate that the return of capital is being made in substitution of dividends. Similarly, the manner in which the proposed scheme is to be carried out, and the form and substance of the proposed scheme, do not indicate that the proposed capital return will be made in substitution for dividends.

Conclusion

53. After having regard to all the relevant circumstances of the scheme, as listed in subsection 45B(8), it is concluded that the proposed scheme to return capital to VTP shareholders is not being entered into for a more than incidental purpose of enabling VTP shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the proposed return of capital.

Application of section 45C

54. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 in relation to the scheme as described, section 45C of the ITAA 1936 will not apply to 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.

Capital gains tax

CGT event G1: section 104-135

55. CGT event G1 will happen when VTP pays the proposed return of capital amount to a VTP shareholder in respect of a share that a shareholder owns at the Record Date and continues to own at the Payment Date (section 104-135 of the ITAA 1997).

56. If the proposed return of capital is less than, or equal to, the cost base of the VTP share at the Payment Date, the cost base and reduced cost base of the share will be reduced (but not below nil) by the amount of the proposed return of capital (subsection 104-135(4) of the ITAA 1997).

57. A VTP shareholder will make a capital gain if the proposed return of capital is more than the cost base of their VTP share. The amount of the capital gain is equal to the excess (subsection 104-135(3) of the ITAA 1997).

58. If a VTP shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the VTP share are reduced to nil (subsection 104-135(3) of the ITAA 1997). A VTP shareholder cannot make a capital loss when CGT event G1 happens.

59. A capital gain made when CGT event G1 happens will be a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the VTP share was acquired at least 12 months before the payment of the proposed return of capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Subdivision are satisfied.

CGT event C2: section 104-25

60. The right to receive the proposed return of capital is one of the rights inherent in a VTP share at the Record Date. If, after the Record Date but before the Payment Date, a VTP shareholder ceases to own their VTP shares in respect of which the proposed return of capital is payable, the right to receive the payment will be retained by the shareholder and is a separate CGT asset.

61. CGT event C2 will happen when the proposed return of capital is paid. The right to receive the payment (being an intangible CGT asset) will end when the payment is made (section 104-25 of the ITAA 1997).

62. A VTP shareholder will make a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right. The capital gain is equal to the amount of the excess. A VTP shareholder will make a capital loss if the capital proceeds from the ending of the right are less than the reduced cost base of the right (subsection 104-25(3) of the ITAA 1997). The capital loss is equal to the amount of the difference.

63. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the proposed return of capital (subsection 116-20(1) of the ITAA 1997).

64. The cost base of the VTP shareholder's right to receive the proposed return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997).

65. The cost base of the right does not include the cost base (or reduced cost base) of the share previously owned by a VTP shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share (for example when the VTP shareholder disposed of the share).

66. Therefore, if the full cost base (or reduced cost base) of the VTP share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share, then the right to receive the proposed return of capital will have a nil cost base.

67. As the right to receive the payment of the proposed return of capital was inherent in a VTP share during the time it was owned, the right is considered to have been acquired at the time when the corresponding VTP share was acquired (section 109-5 of the ITAA 1997).

68. Consequently, if the VTP share to which the payment relates was originally acquired by the former VTP shareholder at least 12 months before the payment of the proposed return of capital, a capital gain made when CGT event C2 happens 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

69. A foreign resident disregards a capital gain or capital loss made from a CGT event that happens in relation to a CGT asset that is not 'taxable Australian property' (section 855-10 of the ITAA 1997). The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997 and covers five categories of assets.

70. Broadly, these categories are:

- taxable Australian real property which is held directly;
- indirect Australian real property interests which are not covered by item 5 of the table in section 855-15 of the ITAA 1997;
- CGT assets used in carrying on a business through a permanent establishment in Australia, and which are covered by item 1, 2 or 5 of the table in section 855-15 of the ITAA 1997;
- options or rights to acquire a CGT asset covered by item 1, 2 or 3 of the table in section 855-15 of the ITAA 1997; and
- CGT assets covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident).

71. A foreign resident VTP shareholder who receives payment of the proposed return of capital, and makes a capital gain when CGT event G1 happens to their VTP shares, disregards the capital gain if the VTP shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

72. A foreign resident VTP shareholder who has a right to the payment of the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens to that right if the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Share consolidation

73. No shares in VTP will be cancelled as a result of the consolidation of VTP shares and there will be no change to VTP's share capital. There will be no change to the proportionate interests held by each shareholder. VTP shareholders will not receive any capital proceeds for the reduction in the number of shares on issue. Therefore, no CGT event will occur as a result of the Share Consolidation.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital benefits
- capital gains tax
- CGT events
- CGT events C1-C3 – end of an asset
- CGT events G1-G3 – shares
- distributions
- dividend income
- dividend substitution
- return of capital on shares
- share capital
- share consolidations and splits

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)
- 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(5)(b)
- ITAA 1936 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 128B
- ITAA 1936 Pt IVA
- ITAA 1936 177A(1)
- ITAA 1997
- 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 104-165(3)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 112-25
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- TAA 1953
- Copyright Act 1968

ATO references

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