


CR 2012/13 - Income tax: return of capital: Copper Strike Limited

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Class Ruling

Income tax: return of capital: Copper Strike 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, 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 provisions

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; and
 - section 855-10 of the ITAA 1997.

All subsequent legislative 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 ordinary shareholders of Copper Strike Limited (CSE), who:

- (a) are registered on the CSE share register on the Record Date;
- (b) hold their CSE shares on capital account;
- (c) are not 'temporary residents' of Australia within the meaning of section 995-1 of the ITAA 1997; and
- (d) 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 CSE shares.

(Note – Division 230 of the ITAA 1997 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 22 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 2011 to 30 June 2012. The Ruling continues to apply after 30 June 2012 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. CSE is a minerals exploration and development company, which listed on the Australian Securities Exchange on 22 November 2004.

11. On 30 June 2011, CSE had 129,455,571 ordinary shares on issue.

12. CSE have advised that as at 12 December 2011 there were approximately 2.9% of shares held by foreign registered shareholders.

13. CSE's exploration and development activity over the last seven years has focussed on projects located in Northern Queensland.

14. CSE recently sold the two projects that represented its asset base.

15. CSE has undertaken a review of its cash needs and capital structure, and determined that it now has an amount of capital that is surplus to its future needs.

16. Accordingly, CSE made a return of capital of approximately \$15 million by way of a payment of \$0.14 per share to all shareholders registered on the Record Date, being 29 December 2011. Payment to shareholders occurred on 6 January 2012.

17. As at 30 June 2011, CSE had over \$7 million in accumulated losses.

18. CSE has not returned a profit in any year, and does not expect to return a profit in the current year.

19. CSE has never paid a dividend to shareholders.

20. CSE has debited the whole of the return of capital against its share capital account.

21. CSE has confirmed that its share capital account (as defined in section 975-300 of the ITAA 1997) is not tainted (within the meaning of Division 197 of the ITAA 1997).

22. CSE has confirmed that at the time of the payment of the return of capital a CSE share was not an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997).

Ruling

Distribution is not a dividend for income tax purposes

23. The return of capital is not a dividend, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C

24. The Commissioner will not make a determination under sections 45A or 45B that section 45C applies to the return of capital. Accordingly, no part of the return of capital is taken to be a dividend for income tax purposes.

Capital gains tax

25. CGT event G1 happened when CSE paid the return of capital to a CSE shareholder in respect of a CSE share they owned at the time of the payment (section 104-135 of the ITAA 1997).

26. CGT event C2 happened when CSE paid the return of capital to a CSE shareholder in respect of a CSE share that they owned at the Record Date but which they ceased to own before the time of the payment (section 104-25 of the ITAA 1997).

Foreign resident shareholders

27. A foreign resident CSE shareholder who was paid the return of capital disregards any capital gain made when CGT event G1 happened if their shares in CSE are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

28. A foreign resident CSE shareholder who was paid the return of capital disregards any capital gain or capital loss made when CGT event C2 happened because the right to the payment is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

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 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 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).

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

31. 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.

32. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account, except for certain limited purposes, 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.

33. The return of capital was recorded as a debit to CSE's share capital account. As the share capital account of CSE is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 will apply. Accordingly, the return of capital is not a dividend as defined in subsection 6(1) of the ITAA 1936.

Anti-avoidance provisions

Sections 45A and 45B

34. 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 proposed return of capital amount received by the shareholders as an unfranked dividend paid by the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

35. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the receipt of capital than other shareholders (the Disadvantaged Shareholders) and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

36. A reference to the ‘provision of a capital benefit to a shareholder in a company’ is defined in paragraph 45A(3)(b) to include the distribution to the shareholder of share capital. CSE provided its shareholders with a ‘capital benefit’ as defined in paragraph 45A(3)(b). The capital benefit was provided to all of its shareholders in the same proportion as their share holdings.

37. Therefore, section 45A will not apply to the 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 return of capital.

Section 45B – schemes to provide capital benefits

38. Section 45B applies where certain capital payments, including a return of capital, are paid 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 (the relevant 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 the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Each of these conditions is considered in paragraphs 39 to 55 of this Ruling.

Scheme

39. 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.

40. 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.

41. As the return of capital was debited to CSE's share capital account, CSE provided shareholders with a capital benefit under paragraph 45B(5)(b) in the form of a distribution of share capital.

Tax benefit

42. A relevant 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.

43. The distribution to CSE's shareholders was a return of capital and therefore constitutes a capital benefit. In the event that the relevant distribution was a dividend rather than a capital benefit, it is likely that the amount of tax payable by CSE's shareholders would be greater than is payable in respect of the return of capital payment (that payment being the capital benefit). Consequently, the receipt of the capital benefit is a 'tax benefit'.

44. Ordinarily, a return of capital would be subject to the CGT provision 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. By contrast, a dividend would generally be included in the assessable income of a shareholder. Therefore, CSE shareholders will obtain a tax benefit from the return of capital.

Relevant circumstances

45. Paragraph 45B(2)(c) requires the Commissioner to consider the 'relevant circumstances' of the scheme as set out in subsection 45B(8). Considering these circumstances determines whether any part of the scheme will be entered into for a purpose, other than an incidental purpose, of enabling the relevant taxpayer (a CSE shareholder) to obtain a tax benefit.

46. The test of purpose is an objective one. The question is whether it would be concluded that a person who enters into or carries out the scheme does so for the purpose of obtaining a tax benefit for the relevant taxpayer. This requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

47. The purpose which causes section 45B to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is concerned only with the purpose of CSE. The Commissioner cannot ascertain the purposes of CSE's numerous shareholders, all of whom were eligible to vote on the return of capital under section 256C of the *Corporations Act 2001*, and all of whom participated in the return of capital. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company should, generally speaking, not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who voted in favour of the payment.

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

49. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised or unrealised) of the company or an associate (within the meaning of section 318) of the company.

50. The return of capital is not considered attributable to the profits of CSE. The distribution is considered attributable to capital only and not to any realised or unrealised profits of CSE.

51. 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.

52. CSE has never had any profits and nor has it paid any dividends. Accordingly, this circumstance neither inclines for or against a conclusion as to purpose.

53. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to 177D(b)(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, the timing of the scheme, its form and substance, and the financial and other implications for the parties involved.

54. In this case, the form and substance of CSE's return of capital does not lead to a conclusion that the requisite purpose exists that the scheme was carried out for the purpose of enabling the relevant taxpayer to obtain a tax benefit.

55. Accordingly, it cannot be concluded that CSE or participating CSE shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain a tax benefit. As such, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole or any part of the return of capital.

Section 45C

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

Capital gains tax

CSE shareholder who owned a share at the Record Date and continued to own that share at the Payment Date

57. CGT event G1 (section 104-135 of the ITAA 1997) happened when CSE paid the return of capital to a CSE shareholder in respect of a share they owned at the Record Date and continued to own at the Payment Date.

58. Where the return of capital payment of \$0.14 per share was less than or equal to the cost base of the CSE share at the time of the payment, the cost base and reduced cost base of the share are reduced by the amount of the return of capital payment (subsection 104-135(4) of the ITAA 1997).

59. A CSE shareholder makes a capital gain if the return of capital payment of \$0.14 per share was more than the cost base of the CSE share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

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

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

CSE shareholder who owned a share at the Record Date and ceased to own that share prior to the Payment Date

62. The right to receive the return of capital is one of the rights inherent in a CSE share at the Record Date. If, after the Record Date but before the payment date of the return of capital, a CSE shareholder ceased to own a CSE share, the right to receive the return of capital in respect of that share will be retained by the shareholder and is a separate CGT asset.

63. CGT event C2 happened when the return of capital was paid (section 104-25 of the ITAA 1997). The right to receive the payment (being an intangible CGT asset) ended by the right being discharged or satisfied at the time the payment was made.

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

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

66. The cost base of a CSE shareholder's right to receive the return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the CSE 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 CSE shareholder disposed of the share after the Record Date.

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

68. As the right to receive the return of capital was inherent in the CSE share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997). Accordingly, if the CSE share was acquired at least 12 months before the return of capital, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided the other conditions of that Subdivision are satisfied.

Foreign resident shareholders

69. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

70. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out five categories of CGT assets:

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a gain or loss on ceasing to be an Australian resident).

71. A CSE share is not an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997). Therefore a CSE share will be 'taxable Australian property' if:

- the CSE share has been used at any time by the foreign resident CSE shareholder in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997), or
- the CSE share is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

72. A CSE shareholder who is a foreign resident just before CGT event G1 happens disregards any capital gain made when CGT event G1 happens if their CSE shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

73. A CSE shareholder who is a foreign resident just before CGT event C2 happens who has a right to receive the return of capital, disregards any capital gain or capital loss made when CGT event C2 happens to that right because the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

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Not previously issued as a draft

Related Rulings/Determinations:

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Subject references:

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- CGT events C1-C3 – end of a CGT asset
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Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
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- ITAA 1936 Part IVA
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- ITAA 1997 104-25
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- ITAA 1997 109-5
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- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25
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- ITAA 1997 116-20(1)
- ITAA 1997 Div 197
- ITAA 1997 197-50
- ITAA 1997 Div 230
- ITAA 1997 855-10
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- ITAA 1997 855-15
- ITAA 1997 855-25
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- ITAA 1997 995-1
- TAA 1953
- Copyright Act 1968
- Corporations Act 2001 256C

ATO references

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