CR 2013/4 - Income tax: return of capital: Energy Infrastructure Trust

Class Ruling

Income tax: return of capital: Energy Infrastructure Trust

Contents Para

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; and
- section 45C of the ITAA 1936.

All subsequent legislative references are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the unitholders of Energy Infrastructure Trust (EIT) who:

- were registered on the Register of EIT on 30 April 2012, being the date for determining entitlement for the return of capital ;and
- were not subject to the taxation of financial arrangements rules in Division 230 of the *Income Tax Assessment Act 1997* (ITAA 1997) in relation to gains and losses on their EIT units.

  (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 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- this Ruling may be withdrawn or modified.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 2011 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for Class Ruling received 13 April 2012; and
- further correspondence dated 6 July 2012, 11 September 2012, 12 October 2012 and 12 November 2012.

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

Overview

10. EIT is an open-ended, unlisted unit trust that was established in February 2003.

11. EIT is treated as a company for income tax purposes as it made a choice, pursuant to sections 713-130 and 703-50 of the ITAA 1997, to be treated as the head company of a consolidated group for income tax purposes from 1 April 2005.

12. EIT has 414,291,251 fully paid units of a single class on issue.

13. All of the EIT units are held by Australian residents for tax purposes.

14. EIT's share capital account, or equivalent account, is not tainted within the meaning of Division 197 of the ITAA 1997.

15. The principal activity of EIT is acquiring, developing and owning investments in energy and utility infrastructure in Australia. Current investments include electricity generation (gas and wind powered), upstream gas, gas and transportation infrastructure and steam generation.

16. The main sources of EIT's profits to date has been:

- gains from the disposal of investments;
- distributions from subsidiaries; and
- interest income.

Profit position and distribution policy

17. Prior to the return of capital, EIT had unrealised gains which were not available for distribution.

18. EIT's distribution policy in relation to half-yearly distributions is as follows:

- A determination is made as to whether EIT has surplus cash holdings – surplus in that the amount of cash exceeds that required to meet its existing obligations and investment opportunities.
- If it is determined that EIT does not have surplus cash holdings then no distribution is made. This was the case in relation to the period ended 30 June 2005.
- If it is determined that EIT has excess cash holdings then a distribution may be made. Distributions are generally made from realised profits first.

Cash position

19. EIT had total cash holdings of $52,201,380 (at 29 February 2012), some of which was surplus to its needs. The cash holdings have arisen from:

- proceeds from underlying business operations;
- disposal of investments; and
- previous capital raising.

Return of capital

20. EIT is primarily financed with capital. External debt funding is not raised by EIT (other than for short term bridging purposes), rather external debt funding is raised at the investment level.

21. EIT distributed $22,267,037 to its unitholders on 15 May 2012 which has been accounted for as a return of capital. This represents a return of capital of $0.06 per unit.

22. EIT had previously made relatively minimal returns of capital.

23. At 30 June 2012, EIT had no short term investment which required funding and has not raised any further capital other than ongoing distribution reinvestment plans.

24. The return of capital was attributable to the uninvested capital resulting from the disposal of investments in the past and past capital raisings.

25. From EIT's perspective, the commercial benefits of the return of capital include:

- improving the rate of return to unitholders (as the return on cash deposits is significantly less than the returns from infrastructure investments);
- meeting the expectations of some unitholders who have communicated a strong preference for the return of surplus cash;
- meeting unit holder expectations that cash flows from operations be returned where appropriate; and
- meeting the requirements of a recent information memorandum which promised a distribution to investors.

Ruling

Distribution is not a dividend for income tax purposes

26. The return of capital by EIT is not a 'dividend', as defined in subsection 6(1).

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

27. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to return of capital by EIT.

Commissioner of Taxation
16 January 2013

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.

Unit Trust considerations

28. As a consequence of the consolidation rules in Division 713 of the ITAA 1997, section 45B of the ITAA 1936 can apply to particular types of trusts. This is due to the fact that certain corporate unit trusts and public trading trusts are treated like a company for tax purposes when they elect to become the head company of a consolidated group. For these trusts the modifications to the applied law pursuant to section 713-140 of the ITAA 1997 provide that a reference to a dividend in the ITAA 1936 and ITAA 1997 includes a reference to a distribution from the trust out of profits and a reference to a share capital account includes a reference to the amount of the trust estate that is not attributable to profits.

29. In the present circumstances, these modifications will result in the distribution from the trust out of profits being treated as a dividend as defined in the ITAA 1936 and ITAA 1997. Further, it will result in an amount of the trust estate that is not attributable to profits being treated in the same way as a share capital account.

30. Sections 713-130, 713-135 and 713-140 of the ITAA 1997 provide that the applied law involves corresponding treatment of analogous characteristics, things and persons relating to a trust to those of a company. For the purposes of simplicity, this Ruling will use the terminology that applies to companies where the trust has engaged in an equivalent transaction but retaining the distinction that unitholders, rather than shareholders, have received the payment.

Distribution of capital is not a dividend

31. 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).

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

33. Relevantly, paragraph (d) of subsection 6(1) specifically excludes from the definition of 'dividend':

> 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…

34. The exclusion in paragraph (d) of the definition of dividend is limited by subsection 6(4) which applies in circumstances where, under an arrangement:

- a company raises share capital, receiving either cash or property from a person or group of persons crediting it to its share capital account; and
- returns it to another person or group of persons, giving them either cash or property, debiting it to its share capital account.

35. In the present circumstances an arrangement of the type contemplated by subsection 6(4) is not apparent. Accordingly, subsection 6(4) will have no application in respect of the return of capital.

36. The return of capital has been recorded as a debit to EIT's unit holder funds account, which is equivalent to a share capital account in these circumstances. As this account 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 applies. Accordingly, the return of capital does not constitute a dividend.

Application of anti-avoidance provisions to the return of capital

Sections 45A and 45B

37. 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

38. 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.

39. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) was provided to participating unitholders under the capital return, the circumstances of this are that the capital return was provided pro-rata to all unitholders which indicates that there was no streaming that would be the equivalent of capital benefits being streamed to some shareholders and dividends being streamed to other shareholders.

40. Accordingly, section 45A has no application to the return of capital.

Section 45B – schemes to provide capital benefits

41. Section 45B applies where certain capital payments 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 (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)).

These conditions are considered below.

The scheme

42. A scheme for the purpose of section 45B is defined under subsection 177A(1) of Part IVA to mean:

- 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.

43. The arrangement involving EIT's return of capital to its unit holders constitutes a 'scheme' for the purposes of section 45B.

A person is provided with a capital benefit by a company

44. 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:

(a) an ownership interest in a company is issued to the person;

(b) there is a distribution to the person of share capital; or

(c) 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.

45. As EIT's return of capital has been recorded as a debit to the unit holder funds account, its unitholders have received a distribution equivalent to a distribution of share capital. Therefore, they were provided with a capital benefit under paragraph 45B(5)(b).

The relevant taxpayer obtains a tax benefit

46. 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 instead had been a dividend.

47. As discussed in paragraph 45 of this Ruling, the distribution of share capital to shareholders is a capital benefit. In the event that the relevant distribution was a dividend rather than a capital benefit, the amount of tax payable by the unitholders would be greater than is payable in respect of a return of capital. Consequently, the receipt of the capital benefit represents a tax benefit.

Relevant circumstances of the scheme

48. Having regard to the relevant circumstances of the scheme as listed under subsection 45B(8), it cannot be concluded that either EIT or EIT unitholders have entered into or carried out the scheme for the purpose of enabling the EIT unitholders to obtain a tax benefit. It cannot be said that the return of capital is attributable to the profits of EIT, nor does EIT's pattern of distributions indicate that the return of capital was made in substitution of dividends. Similarly, the manner in which the scheme was carried out, and the form and substance of the scheme, do not indicate that the return of capital was made in substitution for dividends.

Conclusion

49. After having regard to the relevant circumstances of the scheme, as listed in subsection 45B(8), it is concluded that the scheme to return capital to EIT unitholders has not been entered into for more than an incidental purpose of enabling 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 return of capital.

Application of section 45C

50. 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 apply to 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.

Appendix 2 – Detailed contents list

51. 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 benefit
- capital raising
- dividends
- dividends substitution
- return of capital
- share capital

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 6(4)
- 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(5)(b)
- ITAA 1936 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 177A(1)
- ITAA 1997
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 703-50
- ITAA 1997 Div 713
- ITAA 1997 713-130
- ITAA 1997 713-135
- ITAA 1997 713-140
- TAA 1953
- Copyright Act 1968

ATO references

NO: 1-3UHIU6N
ISSN: 1445-2014
ATOlaw topic: Income Tax ~~ Return of capital