


# ***CR 2014/76 - Income tax: Capital management distribution: Wesfarmers Limited***

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## Class Ruling

### Income tax: Capital management distribution: Wesfarmers 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

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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 44 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- paragraph 128B(3)(ga) of the ITAA 1936
- subsection 128B(3E) of the ITAA 1936
- section 128D of the ITAA 1936
- former section 160APHN of the ITAA 1936

- former section 160APHO of the ITAA 1936
- paragraph 177EA(5)(b) of the ITAA 1936
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- Division 67 of the ITAA 1997
- section 104-25 of the ITAA 1997
- section 104-135 of the ITAA 1997
- section 112-25 of the ITAA 1997
- Division 115 of the ITAA 1997
- section 202-40 of the ITAA 1997
- paragraph 204-30(3)(c) of the ITAA 1997
- subsection 205-15(1) of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-145 of the ITAA 1997
- section 207-155 of the ITAA 1997
- Division 208 of the ITAA 1997, and
- section 855-10 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997, unless otherwise stated.

## **Class of entities**

3. The class of entities to which this Ruling applies are the holders of ordinary shares in Wesfarmers Limited (Wesfarmers) who:

- are registered on Wesfarmers' share register on the date for determining entitlements to receive the capital management distribution consisting of a capital component and a dividend component (the Record Date)
- hold their fully paid ordinary shares on capital account, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Wesfarmers shares.

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

In this Ruling, a person belonging to this class of entities is referred to as a Shareholder.

**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 8 to 41 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**

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7. This Ruling applies from 1 July 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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**

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8. 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.

**Background**

9. Wesfarmers is an Australian resident company listed on the Australian Securities Exchange.

10. Wesfarmers' principal activities include retail operations covering supermarkets, general merchandise and specialty department stores, fuel and liquor outlets and home improvement and office supplies; coal mining; gas processing and distribution; manufacturing of chemicals and fertilisers; and industrial and safety product distribution.

11. As at 30 June 2014, the share capital of Wesfarmers comprised approximately 1,143 million fully paid ordinary shares. The financial statements of Wesfarmers as at 30 June 2014 show share capital of \$22,708 million and retained earnings of \$2,901 million.

## **Disposal of insurance businesses**

12. In December 2013 and April 2014, Wesfarmers announced agreements to divest the insurance underwriting operations and insurance broking and premium funding operations, respectively. Completion of these transactions occurred in June 2014 with net cash proceeds of \$2,970 million from the sale of the insurance businesses.

13. The heritage Wesfarmers insurance business dates back as far as 1919 and the remainder of the insurance businesses were acquired over the period from 2003 to 2007 funded from a combination of surplus funds internally generated and debt facilities.

14. Wesfarmers intends to return approximately \$1,257 million of the total proceeds (approximately 42%) to Shareholders in the form of a special dividend and followed by a capital management distribution (the Distribution). The remaining proceeds will be used to repay debt.

15. On 20 August 2014, Wesfarmers declared a final dividend (fully franked) of \$1.05 per share and a special dividend of \$0.10 per share (fully franked), both dividends to be paid on 9 October 2014. The special dividend is an initial distribution of profits arising from the divestment of the insurance businesses. The special dividend represents a distribution of approximately \$114 million to Shareholders. This Ruling does not apply to this ordinary dividend and special dividend.

16. Also, on 20 August 2014, Wesfarmers announced the proposed Distribution, with Wesfarmers returning to each Shareholder a distribution of \$1 in December 2014, subject to the approval of Shareholders at the Wesfarmers' Annual General Meeting (AGM) which is scheduled for 20 November 2014.

## **The Distribution**

17. Wesfarmers will make the Distribution of \$1 per share representing a distribution of \$1,143 million to Shareholders from the proceeds of the insurance business disposals. The Distribution will comprise of a return of capital of \$0.75 per share (the capital component) and a special dividend of \$0.25 per share (the dividend component).

18. The capital component will be debited to the Wesfarmers' share capital account and will reduce the share capital account by \$0.75 per share. This represents a total capital return of approximately \$854 million to Shareholders.

19. The return of capital, being the capital component of the Distribution, will be effected by way of an equal reduction of capital under section 256B of the *Corporations Act 2001* (Corporations Act), and requires shareholder approval by ordinary resolution under section 256C of the Corporations Act. It is anticipated that shareholder approval will be obtained at the AGM.

20. The return of capital will be paid equally to each holder of a Wesfarmers share who is registered on the Wesfarmers share register on the Record Date.

21. The Record Date for the return of capital is expected to be in late November or early December 2014. The Payment Date is anticipated to be in mid to late December 2014.

22. The dividend component of \$0.25 per share will be fully franked and debited to Wesfarmers' retained earnings account. The dividend component represents a distribution of approximately \$288 million to Shareholders.

### **Share consolidation**

23. In addition to the Distribution, Wesfarmers proposes to undertake a share consolidation of approximately 1 to 0.9827 (or 100 to 98.27).

24. After the share consolidation, Shareholders will own fewer shares that are proportionately higher priced. It is anticipated that the share consolidation will have no effect on the value of each Shareholder's shares relative to the total market value of Wesfarmers.

25. The share consolidation will occur after the Distribution is made to Shareholders and will be applied to fully paid ordinary shares. Following the share consolidation, any Shareholders who hold a fractional number of shares will have their holding rounded to the next whole number of shares.

26. The share consolidation is conditional upon the approval by Shareholders of an ordinary resolution. It is anticipated that shareholder approval will be sought at the AGM.

27. The share consolidation will be undertaken in accordance with section 254H of the Corporations Act such that:

- a Shareholder's original shares will not be cancelled or redeemed
- there will be no change in the total amount allocated to Wesfarmers' share capital account, and
- the proportion of equity owned by each Shareholder in the share capital account will be maintained.

**Other relevant matters**

28. During the year ended 30 June 2014, Wesfarmers had a number of other asset disposals. Proceeds from these disposals are not included in the Distribution.

29. The full year ordinary dividend of \$1.90 per share for the year ended 30 June 2014, amounts to approximately \$2,172 million and represents a payout ratio of 81%.

30. Since 2010, the dividend payout of Wesfarmers has been as follows:

Year ended	Dividend per share	Fully franked dividend paid	Percentage of net profit after tax
30 June 2013	\$1.80	\$2,083 million	92%
30 June 2012	\$1.65	\$1,909 million	90%
30 June 2011	\$1.50	\$1,735 million	90%
30 June 2010	\$1.25	\$1,446 million	92%

31. The high dividend payout policy is intended to be maintained following the Distribution to Shareholders.

32. In the year ended June 2014, retained earnings were \$2,901 million (\$1,701 million post final dividend).

33. Since 2010, Wesfarmers has reported the following retained earnings:

Year ended	Retained earnings	Retained earnings post final dividend
30 June 2013	\$2,375 million	\$1,183 million
30 June 2012	\$2,103 million	\$1,004 million
30 June 2011	\$1,774 million	\$791 million
30 June 2010	\$1,414 million	\$604 million

34. The retained earnings as a proportion of total equity have risen from 2% in the year ended 30 June 2010 to 6% in the year ended 30 June 2014.

35. The net debt to equity ratio of Wesfarmers at 30 June 2014 is approximately 13.2%.

36. In December 2013, Wesfarmers returned approximately \$580 million of capital (\$0.50 per share) to its shareholders. A share consolidation of 1 to 0.9876 occurred in conjunction with the return of capital.

37. Wesfarmers has approximately 21% of its shares beneficially held by foreign residents.

38. A maximum of approximately 9.57% of Wesfarmers shares are held on a pre-CGT basis.
39. Wesfarmers has confirmed that its share capital account (as defined in section 975-300) is not tainted (within the meaning of Division 197).
40. A Wesfarmers share is not an 'indirect Australian real property interest' as defined in section 855-25.
41. A Shareholder's right to the payment of the Distribution is not an 'indirect Australian real property interest' as defined in section 855-25.

## Ruling

### **Dividend component included in resident's assessable income**

42. The dividend component of the Distribution (special dividend of \$0.25 per share) to be paid to Shareholders will constitute a dividend as defined in subsection 6(1) of the ITAA 1936 and the Shareholders must include in their assessable income the dividend component pursuant to subparagraph 44(1)(a)(i) of the ITAA 1936.

### **Gross-up and tax offset**

43. The dividend component of the Distribution is a frankable distribution under section 202-40.
44. A Shareholder who receives the dividend component directly, satisfies the residency requirement in section 207-75 and is a 'qualified person' in relation to the franked distribution:
- must include in their assessable income the amount of the franking credit attached to the dividend component (subsection 207-20(1)), and
  - will be entitled to a tax offset equal to the franking credit attached to the dividend component (subsection 207-20(2)).
45. Shareholders who are entitled to a tax offset under subsection 207-20(2) in respect of the franking credits attached to the dividend component, will also be subject to the refundable tax offset rules in Division 67, unless the Shareholders are specifically excluded under section 67-25.

### **Determination under paragraph 177EA(5)(b) of the ITAA 1936**

46. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by Shareholders in relation to the dividend component.

## **Streaming of imputation benefits**

47. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits in relation to the dividend component received by Shareholders.

## **Dividend stripping operation**

48. The dividend component will not be distributed as part of a dividend stripping operation under section 207-155.

## **Gross-up and tax offset denied in certain circumstances**

49. The entitlement to the tax offset will be subject to the circumstances listed in section 207-145 not arising. Where the Shareholder is a 'qualified person', the dividend component of the Distribution to be made by Wesfarmers will not fall within circumstances listed under section 207-145.

## **Qualified persons**

50. A Shareholder will be a 'qualified person' in relation to the dividend component for the purposes of Division 1A of former Part IIIA of the ITAA 1936, if pursuant to former section 160APHO of the ITAA 1936:

- the Shareholders held their Wesfarmers shares at risk for a period of at least 45 days (excluding the day of acquisition of the shares, the day (if any) on which the shares were disposed of, and any days on which the shareholder has materially diminished risks of loss or opportunities for gain in respect of the shares within the former sections 160APHM and 160APHJ of the ITAA 1936) during the primary qualification period, and
- neither the Shareholder, nor an associate of the Shareholder, make, are under an obligation to make, or are likely to make, a related payment (within the meaning of former section 160APHN of the ITAA 1936) in respect of the dividend component.

## **Exempting entities**

51. Wesfarmers is not an exempting entity or former exempting entity, therefore section 208-195 will not apply to deny the gross-up of a Shareholder's assessable income to exclude the franking credit, nor to deny the tax offset to which a Shareholder would have otherwise been entitled under Division 207.

**Dividend component received by non-resident Shareholders**

52. The dividend component of the Distribution is non-assessable non-exempt income of the non-resident Shareholders other than those who, not receiving the income in their capacity as trustee, carry on business in Australia at or through a permanent establishment in Australia to which the dividend component is attributable (section 128D and subsection 128B(3E) of the ITAA 1936).

53. The non-resident Shareholders, including those who, not receiving the income in their capacity as trustee, carry on business in Australia at or through a permanent establishment in Australia to which the dividend component is attributable, will not be subject to Australian withholding tax in relation to the dividend component (paragraph 128B(3)(ga) and subsection 128B(3E) of the ITAA 1936).

**Credit to franking account for certain corporate tax entities**

54. For a Shareholder that is a 'franking entity' and is entitled to a tax offset under Division 207, in respect of the franking credit on the dividend component, a credit of the franking credit on the dividend component will arise in the Shareholder's franking account on the day the Distribution is made (item 3 in the table in subsection 205-15(1)).

**Capital component is not ordinary income or a dividend**

55. The capital component of the Distribution to Shareholders will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

56. The capital component of the Distribution will not be ordinary income under section 6-5.

**Application of sections 45A, 45B and 45C of the ITAA 1936**

57. 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 capital component of the Distribution.

58. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the capital component of the Distribution.

**CGT consequences*****CGT event G1***

59. CGT event G1 in section 104-135 will happen when Wesfarmers pays the capital component of the Distribution to a Shareholder in respect of a Wesfarmers share that they own at the Record Date and continue to own at the Payment Date.

## **CGT event C2**

60. CGT event C2 in section 104-25 will happen when Wesfarmers pays the Distribution to a Shareholder in respect of a Wesfarmers share that they own at the Record Date but which they cease to own before the Payment Date.

61. Any capital gain made by a Shareholder as a result of CGT event C2 happening is reduced under section 118-20 by the amount of the dividend component of the Distribution that is included in the assessable income of the Shareholder under section 44 of the ITAA 1936.

## **Foreign resident shareholders**

62. A Shareholder who is a foreign resident just before CGT event G1 happens, disregards any capital gain made when CGT event G1 happens because their shares in Wesfarmers are not 'taxable Australian property' (section 855-10).

63. A Shareholder who is a foreign resident just before CGT event C2 happens, disregards any capital gain or capital loss made if CGT event C2 happens because their right to the Distribution is not 'taxable Australian property' (section 855-10).

## **Share consolidation**

64. Under section 112-25, the consolidation of Wesfarmers shares will not result in a CGT event happening as Wesfarmers will convert its shares in accordance with section 254H of the Corporations Act.

## **Appendix 1 – Explanation**

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**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 Component included in resident's assessable income**

65. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 as a distribution made by a company to shareholders, whether in money or other property.

66. The payment of the dividend component will be a distribution of money by Wesfarmers to its Shareholders (within the meaning given in section 960-120).

67. 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).

68. The funds for the payment of the dividend component will be sourced from proceeds of the sale of insurance businesses by Wesfarmers. The payment amount will be debited against Wesfarmers retained earnings account and not the share capital account. Therefore, the exclusion in paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 will not apply.

69. Accordingly, the dividend component constitutes a 'dividend' for the purposes of subsection 6(1) of the ITAA 1936.

70. Paragraph 44(1)(a) of the ITAA 1936 provides that the assessable income of a resident shareholder in a company includes dividends that are paid to the shareholder by the company out of profits derived by it from any source.

71. As the dividend component will be paid out of Wesfarmers' retained profits, Shareholders must include the amount of the dividend component in their assessable income.

### **Gross-up and tax offset**

72. Section 202-30 provides that distributions and non-share dividends are frankable unless it is specified that they are unfrankable. Section 202-45 sets out the circumstances under which an amount or distribution is taken to be unfrankable.

73. Based on the information provided, it is considered that none of those circumstances apply to the dividend component of the Distribution. Accordingly, the dividend component of the Distribution will constitute a frankable distribution under section 202-40.

74. Where a Shareholder receives the dividend component directly, satisfies the residency requirement in section 207-75 and is a 'qualified person' in relation to the franked distribution section 207-20 applies.

75. In accordance with subsection 207-20(1), the franking credit attached to the dividend component must also be included in the Shareholder's assessable income for the income year in which the dividend component of the Distribution is made. The inclusion of both the dividend and the associated franking credit in a Shareholder's assessable income is known as 'grossing-up' the dividend.

76. In accordance with subsection 207-20(2), a Shareholder will be entitled to a tax offset equal to the franking credit attached to the dividend component that has been included in their assessable income in the income year in which the Distribution is made.

77. The refundable tax offset rules in Division 67 ensures that certain taxpayers will be entitled to a refund, once their available tax offsets have been utilised to reduce their income tax liability to nil.

78. Shareholders who are entitled to a tax offset under subsection 207-20(2) in respect of the franking credit on the dividend component will also be subject to the refundable tax offset rules unless the Shareholder is specifically excluded under section 67-25.

79. Entities excluded under section 67-25 include corporate tax entities (such as companies, corporate limited partnerships, corporate unit trusts and public trading trusts), unless they satisfy the requisite conditions as set out in subsections 67-25(1C) or 67-25(1D).

## **Determination under paragraph 177EA(5)(b) of the ITAA 1936**

80. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that targets franking credit trading and dividend streaming schemes where one of the purposes (other than an incidental purpose) of the scheme is to obtain an imputation benefit.

81. If section 177EA of the ITAA 1936 applies, the Commissioner may make a determination under subsection 177EA(5) that either a franking debit or exempting debit of the entity arises in respect of each distribution made to the relevant taxpayer (paragraph 177EA(5)(a)) or, in the alternative, that no franking credit benefit arises in respect of a distribution paid to the relevant taxpayer (paragraph 177EA(5)(b)).

82. Having regard to the relevant circumstances of the scheme, the Commissioner has formed the view that the scheme is not entered into for the purpose of enabling Shareholders to obtain imputation benefits.

83. Accordingly, the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit received in relation to the dividend component of the Distribution.

**Streaming of imputation benefits**

84. Subsection 204-30(1) applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an imputation benefit is, or apart from section 204-30 would be, received by a member of the entity as a result of the distribution or distributions
- (b) the member would derive a greater benefit from franking credits than another member of the entity, and
- (c) the other member of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits.

85. If subsection 204-30(1) applies, the Commissioner has discretion under subsection 204-30(3) to make a determination in writing:

- (a) that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member
- (b) ..., and
- (c) that no imputation benefit is to arise in respect of any streamed distributions made to a favoured member and specified in the determination.

86. For subsection 204-30(1) to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than other members. The words 'derives a greater benefit from franking credits' (imputation benefits) are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

87. Under the arrangement for the payment of the franked dividend component of the Distribution, all Shareholders receive an imputation benefit. Australian resident Shareholders will receive the benefit of a tax offset (paragraph 204-30(6)(a)), or receive a franking credit to their franking account as a result of the distribution (paragraph 204-30(6)(c)).

88. The non-resident Shareholders will receive an imputation benefit in the form of an exemption from dividend withholding tax (paragraph 204-30(6)(e)). Resident Shareholders will derive a greater benefit from franking credits than non-resident Shareholders.

89. However, as the dividend component of the Distribution is franked and paid to all Shareholders, it cannot be argued that Wesfarmers has directed the flow of distributions in such a manner so as to ensure that imputation benefits are derived by Shareholders who derive greater benefits from franking credits, while other Shareholders receive lesser or no imputation benefits.

90. As the conditions in subsection 204-30(1) will not be met, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit received in relation to the dividend component of the Distribution.

## **Dividend stripping operation**

91. A distribution will be taken to be made as part of a 'dividend stripping operation', pursuant to section 207-155, where the making of the distribution arose out of, or was made in the course of, a scheme that was by way of, or in the nature of dividend stripping, or a scheme that had substantially the effect of a scheme that was by way of, or in the nature of, dividend stripping.

92. The documents provided by Wesfarmers give no indication that the dividend component of the Distribution and the associated franking of that dividend to the Shareholders in any way constitute a dividend stripping arrangement. As such, the dividend component will not be distributed as part of a dividend stripping operation.

## **Gross-up and tax offset denied in certain circumstances**

93. Subdivision 207-F creates the appropriate adjustment to cancel the effect of the gross-up and tax offset rules where the entity has made a franked distribution in one, or more, of the following circumstances listed in subsection 207-145(1):

- (a) the entity is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of former Part IIIA of the ITAA 1936;
- (b) the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in respect of the distribution for the entity;
- (c) the Commissioner has made a determination under paragraph 204-30(3)(c) that no imputation benefit (within the meaning given by subsection 204-30(6)) is to arise in respect of the distribution for the entity; or
- (d) the dividend is made as part of a dividend stripping operation (within the meaning given by section 207-155).

94. The Commissioner has confirmed that a determination under paragraph 177EA(5)(b) of the ITAA 1936 and a determination under paragraph 204-30(3)(c) will not be made, and that the dividend component is not made as part of a dividend stripping operation (see paragraphs 80 to 92).

**Qualified Persons**

95. Division 1A of former Part IIIAA of the ITAA 1936 contains the measures known as the holding period rule and the related payment rule which must be satisfied for a taxpayer to be a 'qualified person' with respect to a franked distribution they have received, and thus be entitled to a tax offset for the franking credit attached to the distribution.

96. The test of what constitutes a 'qualified person' is provided in former section 160APHO of the ITAA 1936 as follows:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a **qualified person** in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend - the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of a taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend - the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

97. Former subsection 160APHO(2) of the ITAA 1936, referred to in the preceding paragraph, sets out the holding period requirement. Broadly, if a taxpayer is not under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer will have to satisfy the holding period requirement within the primary qualification period. If a taxpayer is under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer will have to satisfy the holding period requirement within the secondary qualification period.

**Related payment rule**

98. In order to determine the relevant qualification period, it is necessary to determine whether, under the present arrangement, the Shareholders will be considered to be under an obligation to make a related payment. Former section 160APHN of the ITAA 1936 provides non-definitive examples of what constitutes the making of a related payment for the purposes of Division 1A of former Part IIIAA of the ITAA 1936.

99. It is considered that the circumstances surrounding the payment of the dividend component of the Distribution would not constitute an act that passes the benefit to another for the purposes of former subsection 160APHN(3) of the ITAA 1936. As such, it can be concluded that a Shareholder will not be taken to have made or not be likely to make a related payment in respect of the dividend component.

## ***Holding period requirement***

100. As discussed above, the Shareholders are taken, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, to not have made or not be likely to make a related payment in respect of the dividend component, the relevant holding period is thus the primary qualification period pursuant to former paragraph 160APHO(1)(a) of the ITAA 1936.

101. The primary qualification period is defined in former section 160APHD of the ITAA 1936 as follows:

In relation to a taxpayer in relation to shares or an interest in shares, means the period beginning on the day after the day on which the taxpayer acquired the shares or interest and ending:

- (a) if the shares are not preference shares - on the 45th day after the day on which the shares or interest became *ex dividend*...

102. A Shareholder who receives the dividend component will be capable of being a 'qualified person' if:

- they have hold their Wesfarmers shares at risk for a period of at least 45 days (excluding the day of acquisition of the shares, the day (if any) on which the shares were disposed of, and any days on which the Shareholder has materially diminished risks of loss or opportunities for gain in respect of the shares), in the primary qualification period:
  - (a) beginning on the day after the day on which the Shareholder acquired the Wesfarmers shares, and
  - (b) ending on the 45th day after the day on which the shares became *ex dividend* in relation to the entitlement to receive the dividend component.

(former subsections 160APHO(2) and 160APHO(3) and former sections 160APHM, 160APHJ and 160APHE of the ITAA 1936)

and

- neither the Shareholder, nor an associate of the Shareholder, makes, is under an obligation to make, or is likely to make, a related payment in respect of the dividend component of the Distribution (former paragraph 160APHO(1)(a) and former section 160APHN of the ITAA 1936).

103. If either or both of the above two requirements are not met by a Shareholder, that Shareholder will not be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936. Subdivision 207-F will create the appropriate adjustment to cancel the effect of the gross-up and tax offset rules for such a Shareholder in relation to the dividend component of the Distribution.

**Exempting entity and former exempting entity**

104. Division 207 does not apply to a distribution by an exempting entity, unless subdivision 208-G applies.

105. Section 208-20 states that a corporate tax entity is an exempting entity at a particular time if it is effectively owned by 'prescribed persons' at that time. Subsection 208-25(1) provides, in broad terms, that an entity is effectively owned by 'prescribed persons' if not less than 95% of accountable membership interests or accountable partial interests (broadly direct and indirect ownership interests) are held by or on behalf of prescribed persons.

106. Section 208-40 provides the definition of a 'prescribed person' in relation to another corporate tax entity. The definition includes companies, trustees, partnerships or individuals that are a foreign resident or if they were to receive a distribution by the corporate tax entity, the distribution would be exempt income or non-assessable non-exempt income of the company, trust estate, partnership or individual.

107. Based on Wesfarmers' shareholder register as at 30 June 2014, the total percentage of non-resident shareholder ownership in the accountable membership interests of Wesfarmers is 21% and does not amount to Wesfarmers being effectively controlled by prescribed persons. Accordingly, Wesfarmers will not be an exempting entity or former exemption entity under Division 208.

**Credit to franking account for certain corporate entities**

108. Item 3 in the table in subsection 205-15(1) provides that a credit of the franking credit on a distribution made to an entity arises in the franking account of that entity on the day on which the distribution is made if:

- the distribution is a franked distribution
- the entity satisfies the residency requirement for the income year in which the distribution is made
- the entity is a 'franking entity' when it receives the distribution, and
- the entity is entitled to a tax offset under Division 207 because of the distribution.

109. Pursuant to section 202-15, an entity is a 'franking entity' at a particular time if:

- it is a corporate tax entity (within the meaning given by section 960-115) at that time
- it is not a life insurance company that is a mutual insurance company at that time, and
- in a case where the entity is a company that is a trustee of a trust — it is not acting in its capacity as trustee of the trust at that time.

110. Accordingly, if a Shareholder is a 'franking entity' and is entitled to a tax offset under Division 207 in respect of the franking credit on the dividend component, a credit of the franking credit on the dividend will arise in the Shareholder's franking account on the day the Distribution is made.

### **Capital component is not ordinary income or a dividend**

111. The term 'dividend' in subsection 6(1) of the ITAA 1936 includes any distribution made by a company to any of its shareholders. However paragraph (d) of the definition of dividend specifically 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.

112. 'Share capital account' is defined in section 975-300 as an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

113. Subsection 975-300(3) states that an account is not a share capital account if it is tainted.

114. The capital component of the Distribution is a return of capital which will be debited against an amount standing to the credit of Wesfarmers' share capital account. As the share capital account of Wesfarmers is not tainted within the meaning of Division 197, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 will apply and the capital component of the Distribution will not constitute a dividend under subsection 6(1).

115. Further, there is no characteristic of the capital component that would suggest that it would constitute income according to ordinary concepts.

### **Application of sections 45A, 45B and 45C of the ITAA 1936**

#### ***Section 45A of the ITAA 1936 – streaming of dividends and capital benefits***

116. Section 45A of the ITAA 1936 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.

117. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) of the ITAA 1936 will be provided to participating Shareholders under the return of capital, the circumstances of the return of capital indicate that there will be no streaming of capital benefits to some shareholders and dividends to other shareholders.

118. Accordingly, 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 capital component of the Distribution.

***Section 45B of the ITAA 1936 – schemes to provide capital benefits***

119. Section 45B of the ITAA 1936 is an anti-avoidance provision that allows the Commissioner to make a determination that section 45C of the ITAA 1936 applies to treat all or part of a return of capital amount as an unfranked dividend if certain conditions are satisfied.

120. Section 45B of the ITAA 1936 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) 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 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) of the ITAA 1936).

121. Each of these conditions is considered in this Ruling.

*The Scheme*

122. A scheme for the purpose of section 45B is defined in subsection 995-1(1) to include:

- any agreement, or
- any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

123. The arrangement involving Wesfarmers' proposed return of capital to Shareholders will constitute a 'scheme' for the purposes of section 45B.

*Capital benefit*

124. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936. 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.

125. Wesfarmers' return of capital will be recorded as a debit to the share capital account and Shareholders will receive a distribution of share capital to the value of \$0.75 per share. Therefore, the Shareholders will be provided with a capital benefit under paragraph 45B(5)(b) of the ITAA 1936.

### *Tax benefit*

126. A relevant 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 an assessable dividend.

127. A return of capital would ordinarily be subject to the CGT provisions of the income tax law. Unless the amount of the capital component 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). It is only to the extent (if any) that the capital component 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 resident shareholder or in the case of a foreign resident, be subject to dividend withholding tax under section 128B of the ITAA 1936. Therefore, if the return of capital did represent a dividend rather than a capital benefit, it is likely that a Shareholder would incur a greater tax liability. Shareholders will therefore obtain a tax benefit from the return of capital.

### *Relevant circumstances*

128. Paragraph 45B(2)(c) of the ITAA 1936 sets out an objective purpose test for the Commissioner to consider having regard to the 'relevant circumstances' of the scheme as set out in subsection 45B(8) of the ITAA 1936.

129. Subsection 45B(8) of the ITAA 1936 lists a number of factors in paragraphs 45B(8)(a) to 45B(8)(k) that are relevant circumstances in determining whether a person, or one of the persons, entered into or carried out a scheme for a more than incidental purpose of enabling a taxpayer to obtain a tax benefit.

130. In this scheme, the return of capital will be made to all Shareholders regardless of individual circumstances. Therefore, the factors within paragraphs 45B(8)(c) to 45B(8)(h) of the ITAA 1936 do not incline for or against a conclusion as to purpose.

131. The factors in paragraphs 45B(8)(i) and 45B(8)(j) of the ITAA 1936 are not relevant to the circumstances of this scheme. Consequently, the relevant factors are those covered in paragraphs 45B(8)(a), 45B(8)(b) and 45B(8)(k) of the ITAA 1936.

132. Paragraph 45B(8)(a) of the ITAA 1936 refers to the extent to which the capital benefit is attributable to realised or unrealised profits of the company and its associates. A capital distribution out of share capital that is genuinely surplus to the company's needs (for example, release of share capital via a disposal of a significant part of the business structure) is more likely to be attributable to capital rather than being attributable to profits. However, if the disposal also realises a profit the ensuing distribution should, subject to all the other relevant circumstances, be considered in terms of its attribution to both share capital and the profit from the disposal.

133. The sale of the insurance business is not normal operations for Wesfarmers. Wesfarmers has realised a profit on the sale of the businesses and has also released share capital. Wesfarmers has announced a special dividend as an initial distribution of cash realised from the disposal of the insurance businesses and also intends to pay a further special dividend to coincide with the return of capital.

134. As the amount to be distributed from the net proceeds from the sale of the insurance businesses has been apportioned between profit and capital on a reasonable basis and as capital component of the Distribution will be debited to Wesfarmers' share capital account, no requisite purpose exists in which the capital benefit is attributable to profit.

135. Paragraph 45B(8)(b) of the ITAA 1936 refers to the pattern of distribution of dividends, bonus shares and returns of capital or share premium by Wesfarmers or its associates.

136. Wesfarmers is a profitable company that has regularly paid fully franked dividends and has maintained a high dividend payout policy. Wesfarmers has announced that it will pay a special dividend as an initial distribution of cash realised from the disposal of the insurance businesses and a further special dividend to coincide with the return of capital. As the return of capital will not impact on Wesfarmers' franking policy and Wesfarmers intends to continue its policy of paying fully franked dividends, the requisite purpose does not exist.

137. Paragraph 45B(8)(k) of the ITAA 1936 refers to the matters in paragraphs 177D(2)(a) to 177D(2)(h) of the ITAA 1936. 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, among other things, the form and substance of the scheme and its financial implications for the parties involved.

138. The manner in which the return of capital is being undertaken is consistent with ordinary returns of capital and reflects normal commercial activities where capital has been released following an asset divestment and is excess to the company's requirements. The substance of the scheme will be exactly the same as its original form. The timing relates to the divestment of the insurance businesses but has to be communicated and voted upon by the shareholders. The reasons for the scheme are in line with commercial practices and it is not part of a greater scheme.

139. Any changes to the financial positions of the Shareholders are wholly commercial. There are no other consequences under paragraph 177D(2)(g) of the ITAA 1936 for Shareholders to be considered in relation to the return of capital. Wesfarmers is a widely held public company and has not considered the personal circumstances of the Shareholders or any tax benefits that may result.

140. Although a tax benefit has been provided to Shareholders, the benefit is merely incidental. Considering all the factors it cannot be concluded that the scheme was entered into or carried out to enable any relevant taxpayer to obtain a tax benefit in relation to the return of capital. It is accepted that the purpose of the return of capital is to enable Wesfarmers to return to Shareholders additional capital that is excess to its requirements.

141. Accordingly, the Commissioner will not make a determination under subsection 45B(3) of ITAA 1936 that section 45C of ITAA 1936 applies to the capital component of the Distribution.

142. As the Commissioner will not make a determination under subsection 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 capital component of the Distribution to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

## **CGT consequences**

### ***CGT event G1 – section 104-135***

143. CGT event G1 (section 104-135) happens when:

- a company makes a payment to a shareholder in respect of a share they own in the company,
- some or all of the payment is not a dividend (as defined in subsection 995-1(1)) or an amount that is taken to be a dividend under section 47 of the ITAA 1936, and
- the payment is not included in the shareholder's assessable income.

144. No part of the capital component of the Distribution to a Shareholder will be a dividend, nor included in a Shareholder's assessable income. Accordingly, CGT event G1 will happen when Wesfarmers pays the capital component to a Shareholder in respect of a Wesfarmers share that they own at the Record Date and continue to own at the Payment Date.

145. If the capital component (\$0.75 per fully paid share) is not more than the cost base of the Wesfarmers 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 capital component of the Distribution (subsection 104-135(4)).

146. A Shareholder will make a capital gain if the amount of the capital component is more than the cost base of the Wesfarmers share (subsection 104-135(3)). The amount of the capital gain is equal to that excess.

147. If a Shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the Wesfarmers share is reduced to nil. A Shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3)).

148. If the Wesfarmers share to which the capital component relates was acquired by a Shareholder at least 12 months before the payment, a capital gain from CGT event G1 happening may qualify as a discount capital gain under subsection 115-25(1), provided the other conditions in Division 115 are satisfied.

#### ***CGT event C2 – section 104-25***

149. The right to receive the Distribution is one of the rights inherent in a Wesfarmers share at the Record Date. If, after the Record Date but before the Payment Date, a Shareholder ceases to own some, or all, of their shares in Wesfarmers, the right to receive the Distribution in respect of each of the shares disposed of will be retained by the Shareholder and is considered to be a separate CGT asset.

150. CGT event C2 (section 104-25) will happen when the Distribution is made. The right to receive the Distribution (being an intangible CGT asset) will end by the right being discharged or satisfied when the Distribution is made.

151. A Shareholder will make a capital gain if the capital proceeds from the ending of the right to receive the Distribution are more than its cost base. The capital gain is equal to the amount of the excess. A 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. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

152. However, any capital gain made by a Shareholder as a result of CGT event C2 happening is reduced under the anti-overlap rule in section 118-20 by the amount of the dividend component of the Distribution. The dividend component will be included in the assessable income of a Shareholder under section 44 of the ITAA 1936.

153. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount (market value) of the Distribution (\$1 per share) the Shareholder received or is entitled to receive (subsection 116-20(1)).

154. The cost base of a Shareholder's right to receive the Distribution is worked out under Division 110 (modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the 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 Shareholder disposed of the share after the Record Date.

155. Therefore, if the full cost base or reduced cost base of a Wesfarmers 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 Distribution is likely to have a nil cost base.

156. As the right to receive the Distribution was inherent in the Wesfarmers 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).

157. Accordingly, if the Wesfarmers share was acquired by the Shareholder at least 12 months before the Distribution was paid, a capital gain from CGT event C2 happening on the ending of the corresponding right may qualify as a discount capital gain under subsection 115-25(1), provided the other conditions in Division 115 are satisfied.

### ***Foreign resident shareholders***

158. Under subsection 855-10(1), 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'.

159. The term 'taxable Australian property' is defined in the table in section 855-15. The table sets out these 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
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident)

160. Wesfarmers has advised that neither a Wesfarmers share nor a Shareholder's right to the payment of the Distribution is an 'indirect Australian real property interest' as defined in section 855-25, and therefore not taxable Australian property.

161. A foreign resident who is a Shareholder who receives the Distribution will disregard any capital gain made when CGT event G1 happens and disregard any capital gain or capital loss if CGT event C2 happens.

### **Share consolidation**

162. A CGT event will not happen if a company converts its shares into a larger or smaller number of shares (the converted shares) in accordance with section 254H of the Corporations Act in that:

- (a) the original shares are not cancelled or redeemed in terms of the Corporations Act;
- (b) there is no change in the total amount allocated to the share capital account of the company; and
- (c) the proportion of equity owned by each shareholder in the share capital account is maintained.

While there is a change in the form of the original shares, there is no change in their beneficial ownership.

163. The converted shares will have the same date of acquisition as the original shares to which they relate.

164. Where the original shares were acquired on or after 20 September 1985, subsection 112-25(4) provides that each element of the cost base and reduced cost base of the converted shares is the sum of the corresponding elements of each original share.

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

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Not previously issued as a draft

*Related Rulings/Determinations:*

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*Subject references:*

- arrangement
- capital benefit
- capital gains tax
- CGT capital proceeds
- CGT cost base
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- CGT event C2
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- holding period rule
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- related payment rule
- return of capital
- share capital

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NO: 1-5RTZLAD  
ISSN: 1445-2014  
ATOLaw topic: Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events C1 to C3 – end of an asset  
Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events G1 to G3 – shares  
Income tax ~~ Capital management ~~ Assessability of distribution

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