CR 2015/59 - Income tax: return of capital: Krucible Metals Limited

Australian Government
Australian Taxation Office

Class Ruling

Income tax: return of capital: Krucible Metals Limited

Contents Para

This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant 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 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
- Division 115 of the ITAA 1997.

Class of entities

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

- are registered on the Krucible share register on the date (Record Date) for determining entitlements to receive the proposed return of capital,
- are entitled to participate in the return of capital,
- hold their Krucible shares on capital account,
- are 'residents of Australia' as defined in section 6(1) of the ITAA 1936, and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Krucible 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)

In this Ruling, a person belonging to this class of entities is referred to as a 'Krucible 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 9 to 23 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

7. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

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

Background

9. Krucible is an Australian company which was incorporated on 14 March 2006 and which listed on the Australian Securities Exchange on 15 November 2007.

10. Krucible carries on a business of mineral exploration. Its main exploration activities have been carried on in the area surrounding Mt Isa in Queensland.

Sale of phosphate tenements

11. In January 2014, Krucible entered into an agreement to dispose of certain prospective exploration tenements (Phosphate Tenements) for $12,371,000. This was the first disposal of this size and nature which Krucible had undertaken. The sale in early 2014 gave rise to an accounting gain of $8,470,537.

12. Krucible's net profit for the year ended 30 June 2014 was $6,813,982. This profit was applied to Krucible's accumulated losses account as at 30 June 2014.

Strategic review

13. After a change of its board and management, Krucible commenced a strategic review of its exploration activities in late 2014 and determined not to pursue any of its current activities or projects. The results of the strategic review were released in early 2015. The board of Krucible noted that it had not been able to identify exploration opportunities on its current tenement holdings, or any other appropriate investment opportunities that would require the use of all of Krucible's cash holdings.

14. The strategic review gave rise to an accounting impairment charge of $2,835,132.

15. Krucible made a $2,607,925 accounting loss for the six months to 31 December 2014. As at 31 December 2014 Krucible had accumulated losses of $1,898,355.

16. Krucible expects to be in a net loss position as at 30 June 2015.

Torrington Tungsten Project

17. On 15 April 2015, Krucible announced that it will acquire the Torrington Tungsten Project from Resolve Geo Pty Ltd. The consideration to be provided by Krucible will be in the form of fully paid ordinary shares in Krucible and cash reimbursement of $135,000 of past exploration expenditure incurred by Resolve Geo Pty Ltd. 12 million fully paid ordinary shares in Krucible will be provided to Resolve Geo Pty Ltd at the time of acquisition and, subject to shareholder approval, up to a further 12 million fully paid ordinary shares in Krucible will be provided at a later date.

18. Subject to shareholder approval pursuant to subsection 157(1) of the *Corporations Act 2001*, Krucible will change its name to 'TopTung Limited'. The change of name reflects the new exploration focus on topaz and tungsten.

Return of Capital

19. Proceeds of the sale of the Phosphate Tenements will be used by Krucible to progress the Torrington Tungsten Project for 18 months, and to make a return of capital to Krucible Shareholders.

20. Subject to shareholder approval pursuant to section 256C of the *Corporations Act 2001*, Krucible will make a cash distribution of $0.05 per share by way of return of capital. The return of capital will total $4,025,428.25.

21. The return of capital will apply equally and evenly across all shares.

22. The return of capital will be debited against Krucible's contributed equity account.

23. Krucible's contributed equity account is not tainted within the meaning of section 197-50 of the ITAA 1997.

24. The Record Date is 20 August 2015 2015 and the date for the payment to shareholders (Payment Date) is 27 August 2015.

25. Krucible has never declared a dividend to shareholders. Its franking account currently has a nil balance.

26. Krucible has never made any return of capital to its shareholders prior to the return of capital the subject of this Ruling.

27. Approximately 1% of Krucible's shareholders are foreign residents.

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

Ruling

Return of capital is not a dividend

28. The return of capital that will be paid to Krucible Shareholders will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

The application of section 45B and section 45C

29. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the return of capital received by Krucible Shareholders.

Capital gains tax (CGT) consequences

CGT event G1

30. CGT event G1 (section 104-135 of the ITAA 1997) will happen when Krucible pays the return of capital of $0.05 to a Krucible Shareholder in respect of a Krucible ordinary share they own at the Record Date and continue to own at the Payment Date.

CGT event C2

31. CGT event C2 (section 104-25 of the ITAA 1997) will happen when Krucible pays the return of capital of $0.05 per share to a Krucible Shareholder in respect of a Krucible ordinary share they own at the Record Date, but cease to own before the Payment Date.

Commissioner of Taxation
5 August 2015

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.

Return of capital is not a dividend

32. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes a distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution that is debited against an amount standing to the credit of the share capital account of the company.

33. '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 after 1 July 1998 where the first amount credited to the account was an amount of share capital.

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

35. The return of capital will be recorded as being wholly debited to Krucible's contributed equity account. As Krucible's contributed equity account is not tainted within the meaning of section 197-50 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 of $0.05 per share will not be a dividend as defined in subsection 6(1).

Section 45B

36. Section 45B of the ITAA 1936 is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C of the ITAA 1936 applies to treat all or part of the return of capital amount received by the Krucible Shareholders as an unfranked dividend paid by the company out of profits.

Section 45B – scheme to provide capital benefits

37. 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), and
- 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, who entered into the scheme or carried out the scheme or any part of the scheme did so 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).

38. The arrangement involving the return of capital to Krucible Shareholders will constitute a scheme for the purposes of section 45B of the ITAA 1936.

39. The return of capital will be recorded as debit to Krucible's contributed equity account and Krucible Shareholders will receive a distribution of share capital to the value of $0.05 per share. Therefore, Krucible Shareholders will be provided with a capital benefit (paragraph 45B(5)(b) of the ITAA 1936).

40. The meaning of 'obtaining a tax benefit' is defined in subsection 45B(9) of the ITAA 1936 as occurring where the amount of tax payable from the treatment of a return of capital distribution as a capital benefit under the CGT provisions would, apart from the operation of 45B of the ITAA 1936, be less than the amount that would be payable if the distribution had instead been a dividend.

41. As a return of capital will generally result in a lesser amount of tax payable than a dividend, Krucible Shareholders will obtain a tax benefit.

42. 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.

43. Krucible made an accounting profit from the sale of the Phosphate Tenements. The accounting profit was offset against carry forward losses from earlier income years in the 2014 income year. Krucible made an accounting loss in the six months to 31 December 2014 and expects to make a loss in the 2015 income year. Accordingly, Krucible will not have any profits available at the start of the 2016 income year. As a result of its strategic review of its exploration activities, Krucible did not identify any investment opportunities that would require the use of all its cash holdings. Accordingly, Krucible determined that it would make a return of capital to its shareholders.

44. Having regard to the relevant circumstances, it cannot be concluded that Krucible will enter into or carry out the scheme for a more than incidental purpose of enabling the Krucible Shareholders to obtain a tax benefit.

45. Accordingly, 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 whole, or a part, of the payment for the return of capital.

CGT consequences

CGT event G1

46. CGT event G1 (section 104-135 of the ITAA 1997) happens when a company makes a payment to a shareholder in respect of a share they own and some or all of the payment (the non-assessable part) is not a dividend or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

47. Accordingly, CGT event G1 will happen when Krucible pays the return of capital to a Krucible Shareholder in respect of a Krucible share that they own at the Record Date and continue to own at the Payment Date.

48. A Krucible Shareholder will make a capital gain if the return of capital amount is more than the cost base of the shareholder's Krucible share. The amount of the capital gain is equal to that excess (subsection 104-135(3) of the ITAA 1997).

49. If an Australian resident shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the Krucible share is reduced to nil. An Australian resident shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3) of the ITAA 1997).

50. If the return of capital amount is equal to or less than the cost base of the Krucible share at the Payment Date, the cost base and reduced cost base of the ordinary share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

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

CGT event C2

52. The right to receive the return of capital is one of the rights inherent in the Krucible share at the Record Date. If, after the Record Date but before the Payment Date, a Krucible Shareholder ceases to own a Krucible share in respect of which the return of capital was payable, the right to receive the return of capital in respect of that share is retained by the shareholder and is considered to be a separate CGT asset.

53. CGT event C2 will happen when the return of capital is paid (section 104-25 of the ITAA 1997). The right to receive the payment ends by the right being discharged or satisfied when the payment is made.

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

55. 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 paid by Krucible (subsection 116-20(1) of the ITAA 1997).

56. The cost base of the Krucible 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 a Krucible Shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happens to the share, for example, when the Krucible Shareholder disposed of it after the Record Date.

57. Therefore, if the full cost base or reduced cost base of the Krucible share was applied in working out a capital gain or capital loss made when a CGT event happens to that share, the right to receive the return of capital will generally have a nil cost base. As a result, the Krucible Shareholder will generally make a capital gain equal to the amount of the return of capital.

58. As the right to receive the return of capital was inherent in the Krucible 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).

59. Accordingly, if the Krucible share was acquired at least 12 months before the payment of 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 may be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997, provided other conditions of that Division are satisfied.

Appendix 2 – Detailed contents list

60. 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 gains tax
- capital reductions
- CGT asset
- CGT cost base
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 - shares
- distributions
- dividend income
- ordinary shares
- profits
- return of capital on shares
- share capital
- shareholder payments
- unfranked dividends

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- 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)(b)
- ITAA 1936 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Div 115
- ITAA 1997 115-25
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 197-50
- ITAA 1997 Div 230
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- TAA 1953
- Corporations Act 2001
- Corporations Act 2001 157(1)
- Corporations Act 2001 256C

ATO references

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